THE POWER OF TAXATION UNDER THE INDIAN CONSTITUTION

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CERTIFICATE UNDER RULE 7(iii)

This is to certify that the thesis "The Power Of Taxation Under The Indian Constitution" is a record of bonafide research carried out by Shri K. Parameswaran, under my guidance.

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Cochin-22,
July 8, 1976.

THE POWER OF TAXATION UNDER THE INDIAN CONSTITUTION

(Statement under Regulation 7(i))

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The title, and the arrangement of the work have not, to the knowledge of the candidate, been attempted before. Each case is newly summarised, interpreted and criticised. No portion of any other published work or idea has been made of in this work without acknowledgement.

Parameswaran. K

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Cochin-16,
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PREFACE

The Power Of Taxation Under The Indian Constitution, the subject of the present thesis has a wide ambit covering the entire federal field and deep constitutional significance traversing many of the principles like pith and substance, colourability, severability etc. However, considerations of time, space and areas already investigated have indicated that the present study may be confined to the fundamental constitutional limitations and the federal problem. Thus the effect of fundamental rights, the commerce clause, immunity of instrumentalities and the principle limiting the power of legislative delegation on the power of taxation has been studied.

The distribution of taxes between the Union and units of the Indian federation leans so much over to the former and that part of this study has been directed to discover what devices can help the units to gain economic viability.

As far as is known to the present writer the structure and treatment of the subject matter has not been attempted before.

This study would not have been possible but for the help and direction of my teacher Dr.A.T.Markose.

Cochin-16,
8 - 7 - 1976

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INTRODUCTION

INTRODUCTION

The power to tax is an inherent sovereign power of a state to collect a contribution of money or other property from its citizens and the inhabitants of its territory for defraying its general expenditure.[1] Its strategic position in the modern welfare state is such that without it no government can adequately discharge its manifold duties. Its constitutional significance requires legitimate popular sanction for its collection. These are some of the reasons why the term ' tax' has always required a rigid definition at various levels.

The essential nature of tax lies in its being a burden or charge[2] imposed by the legislative power[3] on persons or property for public purposes. Taxation proceeds on the theory that the very existence of the government is a necessity and the tax payer is supposed to receive his just compensation in the protection which the government affords to life, liberty and property.[4] Being an essential and inherent attribute of

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1. See Cooley, The Law of Taxation(4th edn.1924), p.150.
2. See 84 C.J.S. p.30; 71 Am.Juris. 2d.p.343.
3. The definitions given by writers of public finance do not stress this aspect. See Findlay Shirass, Science of Public Finance (3rd edn.1936), Vol.1, p.202; Seligman, Essays In Taxation (10th edn.1921), p.432.
4. Cooley, Constitutional Limitations (1927), p.1055.

sovereignty,[5] the constitutional provisions with respect to taxation are considered as limitations on the power of taxation and not as the grant of power of taxation. Though a federal constitution may delineate the taxing powers of the federal and constituent governments, such a distribution of taxing powers has not been understood to withold the taxing power not expressely provided for.[6] Everything which is subject to the sovereign power is a proper object of taxation.[7] From this statement it follows that tax laws generally can have no extra territorial operation[8] and that the person or property should be within the jurisdiction to attract the liability to tax.

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5. "Taxation, as the source of the public revenue, is of course, a foundation of all political institutions". See Julius Stone, Social Dimensions of Law and Justice(1966, Bombay), p.324.

6. See Sikri,C.J., in Union of India v. H.S.Dhillon, A.I.R. (1972) S.C.1061,1066. "It seems to us unthinkable that the constitution makers while creating a sovereign democratic republic, withheld certain matters or taxes beyond the legislative competency of the legislatures in this country either legislating singly or jointly". But one glaring example of such holding back of taxing powers was S.104 of the Government of India Act, 1935.

7. Hence the immunity from taxation has been extended to the property of other sovereign states in international law as every sovereign state has to respect the independence and dignity of every other sovereign state.

8. The courts of a foreign country will not enforce the liability. According to Lord Mansfield "no country ever takes notice of the revenue laws of another", Holman v. Johnson,(1775) 98 E.R. 1120, 1121.

Art.265 of the Constitution provides that no tax shall be levied or collected except by authority of law.[9] But the word 'law' in this statement comprehends the power of the President of India and Governors of the states, to make law by issuing Ordinances.[10] [11] The executive as well as the judiciary are powerless to impose any tax.

The tax may be in money or in kind. A system of levy of paddy from agriculturists during the harvest season may be viewed as a form of tax on agriculturists if proper conditions already stated are fulfilled. If however the state pays the price of the paddy it collects from the concerned people, then certainly it will lose the character of tax and will partake the character of acquisition. The conscription of men for service in armed forces[12] and a system providing for compulsory public labour[13] by citizens may be viewed as instances of taxes in kind. But all compulsory payments made in favour of the

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9. It has been observed "It is a fundamental principle of sound finance, generally recognized in all civilized countries, that no taxes shall be levied or expenditures authorised without specific action by representatives of the people", W.B.Munro, The Governments of Europe(1947), p. 248.

10. See Arts.123 and 213 of the Constitution.

11. H.L.Mehra v. Maharashtra, A.I.R.(1971) S.C.1130,1131. It was held that no tax could be levied on the basis of administrative instructions. Historically, taxation by the executive had the appellations like"voluntary loans, gracious offerings and forced benevolences". See Latham,C.J., in A.G. for New South Wales v.Homebush Flour Mills,(1937) 56 C.L.R. 390, 400.

12. See International Encyclopedia of The Social Sciences (1972), Vol.XV, p.521 for the view that it is not generally regarded as a tax.

13. See Article 23(2).

state are not taxes and the test in such cases to be applied is whether such payment was made in return for some consideration flowing from the state and if so, such payments cannot be viewed as taxes.[14]

The power of taxation, being an essential attribute of sovereignty, requires differentation from the two other attributes of sovereignty, namely, the police power and the power of eminent domain.[15] The term police power may be defined as the power to make and enforce all wholesome and reasonable laws necessary to maintain and promote public order, public safety, public health, public morals and the general welfare of the society within constitutional limits. In India, since the Constitution provides elaborately for most of the conceivable situations that may arise in the administration of the country, it has been argued that this doctrine of police power need not be imported into the Indian Constitution.[16] This

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14. In Leslie v. Kerala,(1969) K.L.T. 378 the payment by grantees of government lands for obtaining the right to cut certain "royal trees" was held to be not in the nature of tax but only the value of such trees.

15. See 16 C.J.S. 537; 16 Am.Juris.2d.pp.515-516. The police power is considered to be the power of necessity and self preservation and is co-extensive with such necessities, its limits being incapable of precise demarcation.

16. See Bose.J., in Dwarakadas Shrinivas v. Sholapur Spg.& Wvg.& Co., A.I.R.(1954) S.C.119, 137. See also C.H.Alexandrowicz, Constitutional Developments in India (1957),pp.48-49 that under Art.19 the doctrine of implied police powers had no place as the state received express(police) powers in the Constitution to impose restrictions on fundamental rights.

statement only means that in India apart from the grounds mentioned in Art.19 sub-clauses(2) to (6) no other restriction can be imposed on those fundamental rights. Even though police power need not be specifically conferred, there is one such example in Art.31(5) (b)(ii), which expressly provides that Art.31 (2),providing for the prerequisites of a valid acquisition of property, would not apply to a law made for the promotion of public health or the prevention of danger to life or property. Generally speaking, the objects of these two powers,namely, taxing power and police power, being different, one being to collect revenue to defray the expenses of the government,and the other being to promote the general welfare of the people, it would not be ordinarily difficult to designate the exercise of a power either as the power of taxation or police power. The Constitution of India makes a clear-cut division of these two powers in the legislative lists of the Seventh Schedule and the use of the police power to impose a tax is out of question.[17]

The question remains whether the power of taxation can be used for regulation apart from the collection of revenue.

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17. On the question whether police power can be used to collect revenue see Amritsar Municipality v. Punjab, A.I.R.(1970) S.C. 2182,2190, where the State Government took over the schools belonging to the appellant and also demanded contributions from its funds for running the school. The demand was struck down as it amounted to compulsory acquisition of appellant's funds.

In Lord Krishna Sugar Mills v. Union of India,[18] an export promotion scheme for sugar provided for compulsory supply of sugar by the factories for export and as a sanction also provided for additional excise duty on quantity of sugar delivered short of the quota. Upholding the validity of the scheme,[19] Subba Rao, J., observed that if there was no provision imposing a penal cess on defaulters, there would be no sanction to compel them to deliver their quota of sugar. It is well settled that the power to tax involves the power to destroy[20] and it may be said that every tax is in some measure regulatory[21] and to some extent it interposes an economic impediment to the activity taxed compared with others not taxed.

Taxation as regulation may be in the negative form of heavy taxes to prohibit or discourage certain activities[22] like a heavy tax on liquor, or heavy import duty on foreign goods to protect indigenous goods or in the positive form of exemption or rebates granted as incentives to industries or to enforce

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18. A.I.R.(1959) S.C.1124.
19. Ibid at 1140.
20. McCulloch v. Maryland,(1819) 4 Wheat. 316,431.
21. Sonzinsky v. United States,(1937) 300 U.S. 506, 513.
22. Bombay v. R.M.D.C., A.I.R.(1957) S.C.699 was a case concerned with gambling. For cases of heavy taxes on narcotics in U.S.A.see United States v. Doremus,(1919) 249 U.S.86 and United States v.Sanchez,(1950) 340 U.S.42.

labour conditions[23] or codes of conditions of production.[24] An activity which is essentially illegal or unlawful[25] may be subjected to a heavy tax in order to make it unprofitable because direct regulation may not be very effective where such occupation excites or gratifies the passion of large numbers of people.[26] Where the revenue purpose of a tax is only secondary and the primary purpose is regulation of an activity, it has been observed by Mathew, J., in Tamilnadu v. S.D.O., Assn.,[27] "If the tax was otherwise legal, it would not become illegal merely because it was intended to be used also as an instrument to regulate an activity within the power of the State". In R.M.D.C.(Mysore) Pvt.Ltd. v. Mysore,[28] the Mysore Lotteries and Prize Competitions Control and Tax Act, 1951 was upheld as constitutional on the grounds that the court was not concerned with the motive of the legislature[29] and that the State

23. Sunshine Anthracite Coal Co. v. Adkins,(1940) 310 U.S,381, 393.
24. W.R.Moran Pty.Ltd. v.Dy.Commissioner of Taxation,(1940) A.C. 383(P.C.).
25. Minister of Finance v.Smith,(1927) A.C.193(P.C.).
26. Cooley, The Law of Taxation op.cit.,p.3525. Such taxation would not render the activity lawful and entitled to protection by the state. But in the case of a licence fee, the activity which is licensed ipso facto becomes lawful.
27. A.I.R.(1975) S.C.1006. A high rate of tax on contract carriages to eliminate unhealthy competition was upheld.
28. A.I.R.(1962) S.C.594.
29. Ibid at 600. It has been observed that the substance of an enactment is not the motive or the object, but the subject matter and the question in every case is what does the legislature enact. See W.Anstey Wynes, Legislative,Executive and Judicial Powers in Australia (4th edn.,1970), p.37.

Legislature was competent to impose the tax.[30] It was observed "We have already held that the tax imposed under the Mysore Act was not by way of penalty but was the exercise of the power which the legislature possessed of imposing tax under Entry 62". It is submitted that the assumption made by the court that the tax might have been invalid if it was of a penal nature is quite unwarranted. Recently in G.K.Krishnan v.Tamilnadu,[31] an increase in the rate of tax on contract carriages with the avowed object of avoiding unhealthy competition with regular stage carriages[32] was upheld by the court and it was observed that if an authority had power to impose a tax, the fact that that authority gave a wrong reason for exercising the power could not derogate the validity of the tax. Strictly speaking, such a challenge is essentially one as to the colourable nature of the exercise of the power.[33] It is well settled that the

30. Ibid.
31. A.I.R.(1975) S.C.583; see also Karnataka v. D.P.Sharma, A.I.R.(1975) S.C.594.
32. A.I.R.(1975) S.C.583,586.
33. K.C.Gajapati Narayan Deo v.Orissa, A.I.R.(1953) S.C.375,379. The contention that the increase in the rate of agricultural income tax was a colourable measure to diminish the compensation payable to proprietors whose rights were affected under Orissa Estate Abolition Act,1952 was turned down as the Legislature was competent to increase the rate of agricultural income tax. See Maharashtra State Electricity Board v.Kalyan Municipality,A.I.R.(1968) S.C.991,1000 for the view that a tax can be a colourable exercise of the power. On this point see D.K.Singh,"What Cannot be Done Directly Cannot be Done Indirectly"(1959) 32 A.L.J.374 and (1959) 33 A.L.J.3 especially pp.5-6.

doctrine of colourable legislation is a question of competency and not motive and the only question to be answered is whether the legislature has power to tax the activity in question and if the court finds the answer in the affirmative the enquiry stops there.

In a federal constitution, as is the case in India, since there is a distribution of powers between the federal and state governments,[34] the question has sometimes been posed whether the federal or state legislature by exercise of its taxation power "invade any region of legislation, although it is impliedly forbidden to enter it, and this by the simple process of making the liability to the tax depend upon matters within those regions". There are decisions from other federations,[35] in which taxes have been struck down on the ground that such taxes invaded a legislative field demarcated exclusively for the other by the constitution. But the correct approach seems to be to treat such laws only as legitimate exercises of taxation power. To treat a taxation law as invalid,

34. See Griffith, C.J., in King v. Barger, (1908) 6 C.L.R.41,71. (The Commonwealth Excise Tax Act exempted articles manufactured under conditions as to remuneration of labour specified in the statute. The tax was invalidated on the ground that regulation of labour conditions was a matter reserved for state regulation).

35. See Bailey v. Drexel Furniture Co., (1922) 259 U.S.20(a tax on profits by child labour); United States v. Butler, (1936) 297 U.S.1(tax on agriculture, a state subject); A.G. for Canada v. A.G. for Ontario, (1937) A.C.355(P.C.)(employment state insurance was held to be a provincial subject.)

because it gives some advantage or tax exemption if certain conditions are complied with, even though such conditions, pertain to an area in which another government is powerful to regulate,[36] is a needless restriction on the power of taxation.

Even in such a case the result will be that the legislature can use its taxing power " to effectuate a policy or bring about results not directly"[37] within its legislative control. The experience of various federations has shown that such a course is not practical and the maximum that can be done is to give an inducement to state governments to exercise or to abstain from exercising certain power within their jurisdiction. It may be an inducement by way of grant of money to the states who are willing to co-operate or an inducement by way of grant of money if the states refrain from exercising their sovereign power to tax in certain matters.[38] It may be said

36. A federal law providing for a rebate of 90% of the tax to those who contributed to the state unemployment schemes approved by the secretary of the federal treasury was upheld eventhough un-employment was a state subject matter in Steward Machine Co.v. Davis,(1937) 301 U.S.548.

37. See W.Anstey Wynes, Legislative, Executive And judicial Powers in Australia(3rd edn.,1962),pp.50-51 According to the learned author"the difficulties of setting out by way of exemptions a complete code of law on another subject are quite real".

38. South Australia v.Commonwealth,(1942) 65C.L.R.373.It is true that even if one legislature enacted such a law with an ulterior purpose of tempting others to yield, that purpose may be effectively frustrated by the simple expedient of not yielding. See Southerland,J., in Massachusets v.Mellon,(1923) 262 U.S.447,482. Such matters may be enforced through a court of law if the state has received money from federal government. See Maharashtra v.Assn.of Mah.Edn., A.I.R.(1974) S.C.2184.

that in a federation the taxation power cannot be utilised to prohibit the states from exercising their lawful activities. So the legal inducement should not take the form of a threat or coercion.[39] If a tax prohibits constitutionally permitted activity of another unit of the federation, it is a matter to be dealt under the doctrine of immunity of instrumentalities. The result should be the same even if such law is in aid of a legislation by another legislature or to effectuate an agreement with another government,[40] and even if the tax is demanded" solely as a penalty for an unlawful act or omission"[41] under the other law. It is for the legislature to determine the circumstances ~~and circumstances~~ and conditions to fasten the tax liability and such incidental matters should not be decisive in determining the validity of a tax law. The possession of such ~~a~~ power by the federal legislature is all the more important where the several states find it difficult to regulate or prohibit an activity which has inter-state ramifications.

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39. "Threat of loss, not hope of gain, is the essence of economic coercion" Stone, J.,(dissenting) in United States v.Butler,(1936) 297 U.S.1,81.
40. W.R.Moran Pty.Ltd. v.Dy.Commissioner of Taxation,(1940) A.C.838. The Privy Council upheld a scheme to pay fair pric to wheat growers and a tax on flour sold in Australia. In the case of Tasmania, as no wheat was grown there, the amount collected by way of tax was returned to tax payers. The legislations giving effect to the scheme was upheld. For criticism see Anstey Wynes,op.cit.(4th edn.1970),p.41.
41. In King. v.Barger,(1908) 6 C.L.R.41,99. Isaacs, J.,(dissenting) laid down the following test to determine whether the imposition was a tax or regulation."Is the money demanded as a contribution to revenue irrespective of any legality or illegality in the circumstances upon which th liability depends, or is it claimed as solely a penalty for an unlawful act or omission, other than non-payment o or incidental to a tax".

The power of eminent domain has been defined as the inherent political right founded on a common necessity and interest, of appropriating the property of individual members of the community to the great necessities of the whole community and is considered to be an inherent attribute of sovereignty.[42] According to Wills, the power of eminent domain is not an incident of tenure, but an offspring of political necessity.[43] Some writers attribute the source of the concept of eminent domain to the natural law movement.[44]

Though in the exercise of powers of taxation and eminent domain, private property is appropriated for public use, in eminent domain private property is taken from an individual not as a share of general burden but is in the nature of a forced sale generally imposing a condition to repay the value of such property. Art.31(2) of the Constitution of India imposes two conditions on the exercise of the power of eminent domain, namely, that it should be for a public purpose and that an amount should be given to the owner of the property. Art.31(5) (b) (ii) excluded taxation laws from the operation

42. 26 Am.Juris.2d.pp.638,639.
43. Willis, Constitutional Law of The United States(1936),p.225.
44. Arthur Lenhoff,"Development of The Concept of Eminent Domain"(1942) 42 Col.L.Rev. 596-597.

of Art.31(2)[45], In the case of taxation, the compensation is not direct, but only theoretical as the person taxed can participate in the public benefit accruing from the expenditure of the money. Both taxation and power of eminent domain are legislative powers exercisable for public purposes.

Though the power of eminent domain and the power of taxation are different juristic categories, there are instances of the former being used to collect revenue. In Venkata Subba Rao v. Andhra Pradesh,[46] the facts were as follows. The appellant was an agent of the State Government to procure rice from agriculturists. The Government later raised the selling price of rice and this resulted in the appellant getting huge profits as he had purchased the rice earlier at lower price. The Government in order to recover these unearned profits issued

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45. "It is, we think, impossible to hold that the mere increase of an assessment for land revenue involves any acquisition of the land or any rights in or over immovable property". Spens,C.J., in Kunwar Lal Singh v.C.P. and Berar, A.I.R. (1944) F.C.62,65.
46. A.I.R.(1965) S.C.1773. In a decision from Australia A.G. for New South Wales v. Homebush Flour Mills,(1937) 56 C.L.R. 390 the State notionally acquired all flour produced inside the State at a low price with an option to the owner to repurchase it at a higher price. The High Court invalidated the scheme as an attempt to levy an excise duty which the federal legislature alone had power to impose. It is clear that the Court would have upheld the scheme only if the legislature was competent to levy excise duty and if so the conclusion follows that the power of eminent domain can be used to collect revenue in Australia only if the power to impose such tax also was possessed by the legislature. This decision has no application in India, as here it is well settled that a legislation cannot be challenged for improper motive.

orders for acquisition of the stock of rice of the appellant under the Essential Supplies(Temporary Powers) Act,1946 at a low price and agreed to release the stock only if the appllant either paid or agreed to hand over such money to the Government. The Supreme Court by a majority struck down the order ån the ground that it was a case of taxation by the executive.[47] Sarkar, J., (dissenting) held that the procedure for acquisition was valid and did not result in an unauthorised levy.[48] The case presents a really difficult problem as it may be argued that there is nothing illegal if the state has power to acquire property, does so and sells such property later to have a profit. In such cases it is difficult to equate such action to taxation.[49]

The power of taxation, being the most potent weapon to raise money and to bring about social and economic changes, is also liable to be abused. One of the inherent limitations on the power of taxation is that the legislature should not impose taxes for the benefit of private persons or in aid of private enterprises.[50] It has been stated that this restriction grows[51]

47. Rajagopala Ayyangar and Bachawat, JJ. A.I.R.(1965),S.C.1773, 1790.
48. Ibid at 1777.
49. Such action may be challenged as an abuse of the power of eminent domain.Municipal Council of Sydney v.Campbell,(1925) A.C.338,343.But the doctrine of abuse of power has no application to legislative action and if the legislature specially authorises such a course by the executive,the courts will find it difficult to interfere.
50. "To lay,with one hand,the power of the government on the property of the citizen,and ~~th~~ with the other to bestow it upon favoured individuals to aid private enterprises and building up private fortunes,is none the less a roberry because it is done under the forms of law and is called taxation"Citizens Savings & Loan Assn. v.City of Topeka, (1874)22 L.Ed.455,461.
51. 84 C.J.S.pp.64-65.

out of the essential nature and purposes of all free governments and is inherent in the subject itself and implied in all definitions of taxes or taxation. Taxation in aid of private enterprises has been properly characterized as"to load the tables of the few with bounty that the many may partake of the crumbs that fall therefrom"[52]. Although it has been stated that requirements of public purpose will be satisfied only if some direct and immediate benefit or convenience accrued to the public, it is difficult to say clearly in what cases a tax would be considered one for a private purpose. Under the Indian Constitution this requirements may be said to follow from Art.19 (1)(f) &(g) read along with Art.19(5)& (6)[53]. A tax for private purpose may be challenged as an unreasonable restriction not in the interest of general public on the citizen's right to acquire, hold and dispose property or on his right to carry on any trade, occupation or business. The term "public purpose" in the context of law of taxation may not be the same as in the law of eminent domain under Art.31(2) of the Constitution of India. This is because under Art.31(2) even if private

52. Cooley,The Law of Taxation,op.cit.,p.465. See generally 71 Am.Juris.2d,pp.371-388; Cooley, The Law of Taxation op. cit.,pp.386-460.
53. In the United States of America this requirement is said to follow from the "due process clause" Willis,Constitutional Law,op.cit.,p.803.

property is acquired for a private purpose no serious injury is occasioned, as the owner of the property gets compensation. But it is submitted that the definition by Batchelor, J., in Hamabai Framjee Petit v. S.S. for India,[54] that "it is enough to say that in my opinion, the phrase, whatever else it may mean, must include a purpose, that is an object or aim in which the general interest of the community as opposed to particular interest of individuals, is directly and vitally concerned" may be considered as a general test and individual decisions as to what is and what is not a public purpose under the law of eminent domain is not applicable to the law of taxation. Though the judiciary is competent to examine whether a tax is imposed for a private purpose, the presumption is always in favour of the validity of the tax and the burden will be on the person who challenges the validity to establish the contrary. The court will interfere to strike down a taxation law only in extreme cases or where the avowed purpose is one prohibited by the Constitution itself. For example, Art.27 of the Indian Constitution reads "No person shall be compelled to pay any taxes, the proceeds of which are speciefically

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54. (1915) I.L.R.39,Bom.279,291. It was observed this in the case of the King's Prerogative in Saltpetre, (1606) 77 E.R. 1294,1295" for the case of saltpetre extends to the ~~differe~~ defence of the whole realm, in which every subject hath benefit; but so it is not in the case of the reparation of the King's houses".

appropriated in payment of expenses for the promotion or maintenance of any particular religion or religious denomination".

Regarding the ambit of Art.27 it has been observed[55] that it was against the policy of the Constitution to pay out of public funds any particular religion or religious denomination. Even such an express prohibition has been much watered down by the courts in India. The Kerala High Court in K.Reghunath v. Kerala[56], held that Art.27 did not prevent the State from spending its funds for renovation of mosques and temples damaged in the course of a communal riot. It was held[57] that restoration or reconstruction of the places of wark worship of even a particular religious denomination would not amount to promotion or maintenance of that religous denomination. In Bira Kishore v. Orissa.[58] the Court upheld the expenditure of public money for renovation of tanks of hindu temple, as those tanks had become places of breeding of mosquitoes. This decision stands on a different footing as the State can always step in in the interests of public

55. Mukherjea, J., in Commr.H.R.E. v. L.T.Swamiar, A.I.R. (1954) S.C.282,296. In Bashir Ahmed v.West Bengal,A.I.R. (1976) Cal.142 the contribution levied on wakfs under Bengal Wakfs Act,1934 for the education of mohammedan children was held to be not the maintenance of a particular religion.
56. A.I.R.(1974) Ker.48,50. The Government had granted Rs.1,25,000/- to a committee. The conclusion of learned judges that there was no appropriation of money is clearly wrong because such appropriation was made from contingency fund under Art.267 pending authorisation by legislature.
57. Ibid at 51.
58. A.I.R.(1975) Ori.8.

convenience and proper sanitation.[59] The latitude shown in this area by courts in upholding the expenses of money in aid of religious institutions is clearly unwarranted by the constitution. For example, recently in Rajasthan v.Sajjanlal Panjawat,[60] the reasonablenessof a fee taken from religous institutions was in question. The State attempted to justify it on the ground that the collection did not exceed the actual expenditure. The figures showed that the income from collections was only Rs.3,000/- and the expenditure incurred by the Government for the maintenance of the devasthan department was Rs.2,76,715/-. It was neither argued nor noticed that the State was spending public money(to an extent of Rs.2,73,715/-) for the maintenance and upkeep of hindu religious institutions. This is definitely not a public purpose.

From the above discussion, it follows that a tax can be challenged if it is levied with an object to assist certain private interests.[61] But it is only rarely that taxes, whose

59. But why they should be renovated for the benefit of hindus? Why not the state fill them up and put an end to the mosquitoe breeding or why not the state claim the whole expenses or even a part of it from the temple authorities? Recently in Suresh Chandra v.Union of India,A.I.R.(1975) Del.168 the expenditure of money for cultural programme to celebrste the 2500th anniversary of Bhagwan Mahavir was upheld as not one promoting Jain religion.
60. A.I.R.(1975) S.C.706,725.
61. Where an exception is made in favour of certain classes,it should be made in the interests of general public and not with a view to grant some favour to certain persons. See John Cherian v.Kerala, (1974) K.L.T.179,185.(Issac,J.)

proceeds are to be expended for a specific purpose are provided in the statute itself.[62] Under the Indian Constitution all revenue go to the consolidated funds of the Union and State Governments and money can be taken out of it only by way of appropriation acts passed by the legislature.[64] Further, tax receipt is only one of the items of the revenue of a government and it is highly difficult to say that the money so appropriated for a private purpose was related to any particular tax receipts. Hence the statement that taxes cannot be levied for any private purpose boils down to a rule that an appropriation act could be challenged on the ground that the intended expenditure was purely private or unauthorized.[65] Even so, in such cases only the particular appropriation act will be rendered invalid and not

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62. For example different kinds of cesses and fees.
63. See Art.266.
64. See Arts.114 and 204.
65. In Massachusetts. v.Mellon,(1922) 262 U.S.447,486 it was held that such a right of a tax payer to challenge an appropriation act had never been passed upon by the Court. Stone,J.,(dissenting) in United State v.Butler,(1936)297 U.S.I, 85 gives a very wide scope to the spending power of the state. But there is equally high contrary opinion by the Privy Council. Lord Atkin in A.G.for Canada v. A.G. for Ontario, (1937) A.C.355,366, "But assuming that the Dominion has collected by means of taxation a fund, it by no means follows that any legislation which disposes of it is necessarily within Dominion competence". In Australia A.G.for Victoria v. The Commonwealth,(1945) 71 C.L.R.237 is an instance of invalidating an appropriation act.

any taxing statute by which money was collected by the state.[66] Where the tax itself proclaims the particular purpose for which the collections are to be expended, the courts have readily examined whether the tax is for a public purpose. Recently, the Supreme Court has examined the validity of two tax legislations in D.Ramaraju v.Andhra Pradesh,[67] and Vivian Joseph Ferreria v. Bombay Municipality,[68] In both these cases the challenge was that the levy on the petitioners was to meet the

66. See Latham, C.J., in South Australia v.The Commonwealth, (1942) 65 C.L.R.373,415. "But, even if it can be assumed that an appropriation can be invalid(as here contended with reference to the Grants Act), such invalidity cannot reflect back upon any tax Act so as to make it invalid". The learned Chief Justice doubted whether it could be contended that because the payment might have been made out of receipts from income tax that therefore the income tax laws of the Commonwealth were invalid?

67. A.I.R.(1972) S.C.828. The Andhra Pradesh(Krishna & Godavari Delta Area) Drainage Cess Act, 1968 provided for a levy of drainage cess on owners of land to meet the expenditure of flood prevention scheme. The Court upheld the levy.

68. A.I.R.(1972) S.C.845. The Bombay Buildings Repairs and Reconstruction Board Act,1969 provided for a levy on certain buildings to meet the expenses in carrying out structural repairs of residential buildings let out to tenants, which were in dangerous conditions. The court upheld the levy.

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expenditure for the benefit of other land owners[69] and building owners[70]. Rejecting these contentions, the Court held that the levy was for public purpose in both cases.[71] These decisions clearly show the difficulty in establishing the fact that the purpose was private and it may be said that the court will interfere on this ground in a case only where the avowed purpose is so conspicuously private[72] as to render the exercise of the power of taxation an abuse or colourable exercise of the power.

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69. According to Cooley, taxation proceed on the theory that it only secures to the citizen that general benefit which results from protection to his person and property and the promotion of those various schemes which have for their object the welfare of all. It is no defence to the collection of tax for a special purpose that the person liable for the tax is not benefitted by the expenditure of the proceeds of the tax or not as much benefitted as others. See Cooley, The Law of Taxation, op.cit.p.214.

70. In Ramaraju v. Andhra Pradesh, that the land belonging to the petitioner was never affected by floods. A.I.R.(1972) S.C.828,837.

71. In V.J.Ferreria v.Bombay Municipality, the contention was that the petitioner's building did not require any repair or reconstruction. A.I.R.(1972) S.C.845,853.

72. If the exaction has a legitimate governmental objective,it does not matter whether the proceeds are apportioned among a limited segment of the community. See Lower Mainland Dairy Products Sales Adjustment Committee v.Crystal Dairy Ltd.,(1933) A.C.168, 175.(P.C.)

At the legislative level the tax has to be distinguished from certain other impositions of like nature.[73] An important item of public revenue in modern times, where state is increasingly undertaking production and supply of essential commodities and essential services, is the charges called price realised for such commodities and services.[74] Prices are said to be[75] like fees in that they are charges for special services[76] but they differ from fees in not being compulsory, since the consumer or purchaser can go without the services rendered. In essence, prices differ from taxation as being not compulsory and in the fact that they are charges for services of a commercial character rather than governmental services[77]. Hence the executive government does not require the assistance of a legislation either to give services or to

73. The further inner distinction between a tax and a fee, being charges for specific services rendered by the state, is not relevant here and dealt with elsewhere separately.
74. According to Dalton, every law which creates state monopoly may be said to be in part a taxing law, as that part of the price which exceeds the cost of production is indistinguishable in principle, from a tax on such commodities. See Dalton, Principles of Public Finance, (London, 1966), p.18.
75. See Findlay Shirass, The Science of Public Finance(1936), p.202.
76. In India, the Government has total monopoly over air ways, railways, post and telegraph, telephone etc. and partial monopoly in road transport. Moreover, the Government owned companies produce articles of necessity and luxury.
77. Aditya Mills v. Rajsthan Ele.Bd., A.I.R.(1969) Raj.254,259. The charge levied for consumption of electricity was held to be in the nature of price.

accept payments for them.[78]

Fines and other penalties imposed by criminal courts and other tribunals, though have some of the characteristics of a tax, are levied not with a view to collect revenue but as a sanction for violation of law. According to Seligman, the power to adjudge fines and penalties belonged rather to penalogy and administration than to the science of finance.[79] Even when a taxing statute provides for imposition of penalty or fine, the object may be to check the evasion of tax. Penalty in such cases has been held to partake the character[80] of additional tax and not merely sanction.[81] However, good receipts of revenue from penalties would go to show that the state has failed to achieve its deterrent objective in preventing evasion of tax.[82] So the success of a law imposing a fine or penalty is inversely proportional to the receipts while that of a tax law is generally directly proportional to the receipts.[83] Tax is not considered to be a debt, as being not contractual and normally interest does not accrue on the amount unless the law imposing the tax specifically provides so and

78. Ram Jawaya Kapur v. Punjab, A.I.R.(1955) S.C.549,557. See also Art.298 of the Constitution of India.
79. Seligman, Essays in Taxation, op.cit.p.402 In the case of penalty, private property is taken without reference to the needs of the state.
80. Jain Bros. v.Union of India,A.I.R.(1970) S.C.778,783.
81. Ray,C.J., in Khemka & Co. v.Maharashtra, A.I.R.(1975) S.C. 1549, 1555.
82. Of course if such provisions are strictly enforced.
83. There is one exception, i.e. where the object of the tax law is merely regulatory.

is also not liable to set off[84]. Generally taxes are considered to be obligations or liabilities[85] and usually taxing statutes provide for a charge[86] and priority for realisation of taxes in cases of liquidation.[87]

The power of the state to appropriate private property under powers over bona vacantia and escheat require mention here.[88] The term bona vacantia is applied to movables in which no one can claim a right to property and includes wrecks,[89] treasure trove,[90] waifs, estrays etc. Such property belonging to unknown persons thus escapes seizure by would-be possessors and is used for the general good rather than the chance enrichment of particular individuals or organizations.[91] Art.296 of the Constitution of India provides for the power of the states and the Union of India to acquire property by escheat,

84. See 71 Am.Juris.2d.p.346.
85. But courts would not enforce a tax liability on a foreign country even in liquidation proceedings. See Government of India v.Taylor,(1955) A.C.491.
86. A charge so created, unless specifically provided, is subject to ordinary law under Transfer of Property Act,1882. See Ahmedabad Municipality v.Haji Abdul, A.I.R.(1971) S.C. 1201,1204.
87. See In re Silver Brothers Ltd.,(1932) A.C.514(P.C.).
88. See Halsbury's Laws of England,2nd edn.Vol.VII,p.536. The principle is that as "there being no private person entitled, the Crown takes". See Rex v.A.G.of British Columbia,(1924) A.C.213,219.
89. Namely unclaimed wrecks including float-sam,jet-sam, lagan or ligan and derelict found in or on the shores of the sea etc.
90. See Treasure Trove Act,1878.
91. Read, J., in Standard Oil Co. v. New Jersey,(1950) 341 U.S. 428,436. Abandoned properties such as debts,(Anderson National Bank v.Luckett,(1943) 321 U.S.233,240) and life insurance policies(Connecticut Mutual Life Insurance Co.v. Frank C.Moore ,(1947) 333 U.S.541) are appropriated by the state.

lapse or bona vacantia. In Bombay Dyeing and Mfg.Co.v. Bombay,[92] the constitutionality of Bombay Labour Welfare Fund Act,1953, which required an employer to handover to the State all unclaimed and unpaid payments due to the employee was challenged. The Act did not absolve the liability of the employer to the employee and the Court struck down the legislation as violative of the Constitution.[93] It was also held that a law which vests such property absolutely in the state without regard to the claims of the true owners could not be considered as one relating to abandoned property. The legislation was subsequently amended and was the subject matter of challenge in Gujarat v. Shri Ambica Mills[94]. The amended Act relieved the employer of the liability to the employee to the extent of money paid under the Act and also provided for public notice and for adjudication of any subsequent claim by any employee. Upholding the validity of the Act,Mathew, J.,[95] observed that the sovereign had a prerogative right to appropriate bona vacantia.

The valuable minerals like gold and precious stones, whether found in lands belonging to the government or private persons belong to the government by virtue of sovereign

92. A.I.R.(1958) S.C.328.
93. Ibid at 340(Venkatarama Aiyar,J.,).
94. A.I.R.(1974) S.C.1300.
95.Ibid at 1305.

prerogative right.[96]

The term"escheat" means the power of the sovereign state to take property of a deceased dying intestate without heirs. This power is an incident or attribute of sovereignty and rests on the principle of the ultimate ownership of the state of all property within its jurisdiction.[97] Originally[98] under the English,Law, escheat was strictly an incident of feudal tenure and the King took it as the last lord or lord paramount.[99] In India this power has been conceded to the[100] government from taxing power as here the state acts in the

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96. See Attorney General of British Columbia v.Attorney General of Canada,(1889) 14 A.C.295,302; Esquimalt And Nanaimo Railway Co.v. Bainbridge,(1896) A.C.561(an ordinary grant of land would not include a transfer of the right to precious metals.
97. 30 C.J.S. p.116. The view that it is taken by way of succession or inheritance is not certainly accurate. See Earl of Selborne in A.G. of Ontaria v.Mercer,(1883) 8 A.C. 767,772. But in countries like Spain,the state takes the property as a heir. See In the Estate of Maldonado, (1954) P.223,229-230.
98. Bachawat. J., in P.Leslie & Co.v. V.O.Wapshare, A.I.R. (1969) S.C.843 ,848. See Tek Chand, J.,in Phuman Singh v. State of Patiala, A.I.R.(1961) Punj,200,202."When there is no longer any tenant, the land returns,by reason of tenure,to the lord by whom, or by whose predecessors in title, the tenure was created" Earl of Selborne in A.G. of Ontario v. Mercer,(1883) 8 A.C.767,772.
99. It has been held that a Zamindar in India could not claim to exercise this power. See Ranee Sonet Kowar v.Mirza Himmut Bahadoor,(1076) 3 I.A.92,101.
100. See Knight Bruce, L.J., in Collector of Masulipatam v, Cavaly Vencata Narrainapah,(1860) 8 M.I.A.500,526-527; See Bachawat, J., in P.Leslie & Co.v. V.O.Wapshare, A.I.R.(1969) S. C.843,849-850(property of a dissolved company passed by escheat or as bona vacantia).

exercise of its sovereign power to protect or appropriate ownerless, abandoned or unclaimed property without any reference to other things.

The power to provide for forfeiture of any amount lying with the state though is an exercise of sovereign power is different from the power of taxation. Forfeiture of money is provided usually in cases of breach of certain conditions.[101] The term forfeiture may also mean an amount which becomes liable to be so taken as a penalty.[102]

<u>Canons of Taxation</u>

The canons[103] of good taxation propounded by the writers of public finance require a brief mention. The first among them is that taxes should be levied with equality and uniformity in accordance with reasonable principle of apportionment so that each taxpayermay contribute in accordance with his respective ability. Hence progressive taxation based on

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101. See O.XXI.r.86 Civil Procedure Code 1908, which provides for forfeiture, if an auction purchaser fails to deposit the balance of the purchase price within fifteen days into the court.

102. See <u>Gammon India Ltd</u>. v. <u>Union of India</u>, A.I.R.(1974) S.C. 960,967,(Ray, C.J.)

103. The earliest one is by Manu in India" As the leech, the calf, and the bee take their food little by little, even so must the King draw from his realm moderate annual taxes". See Max Muller, Sacred Books of The East, Vol. XXV.p.236. Another one from ancient Rome is " A good shephered should shear his flock not skin it". See ~~Baitanx~~R James Coffield, A Popular History of Taxation from Ancient to Modern Times (1970,Longman),p.33.

capacity to pay should be the aim of taxation.[104] Secondly, the amount of tax which each individual is bound to pay should be capable of being ascertained with reasonable certainty and should not be arbitrary.[105] This requirement is satisfied if the law imposing the tax lays down in clear terms the liability and provides for an opportunity to be heard before a person is required to pay the tax and also for an appeal to some higher authority. Thirdly, every tax ought to be levied at a time or in a manner which is most convenient for the tax-payer to pay.[106] Fourthly, expenses for collection of tax should be as low as possible. The remaining five canons of taxation aim at a wholesome revenue system. They are productiveness,[107]

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104. According to Dalton, all forms of regressive taxation, such as poll tax, or taxes on necessities should be avoided as far as possible. See Dalton, Public Finance, op.cit.pp.65-66. But the Report of the Taxation Enquiry Commission reads" It is inevitable in underdeveloped countries seeking to accelerate the tempo of their economic development that their tax systems must suffer some departure from the strict basis of ability to pay, if the targets of economic development which form the imperatives of their national policies are to be attained within a reasonable period". See Report(1953-54),Vol.1. p.148.
105. Seligman, Essays In Taxation, op.cit.p.390.
106. Payment of salary after deducting the income tax payable, is an instance.
107. That the taxes should bring in adequate revenue.

flexibility,[108] elasticity,[109] simplicity and diversity.[110] It has been also said that where there is a conflict between any two or more principles, the most important of them should be preferred.[111]

The Problem

The Constitution of India envisages a sovereign democratic republic to secure to all its people social and economic justice. Though the Constitution does not subscribe to any definite economic theory as such, certain provisions of the directive principles of state policy certainly indicate that what is intended to achieve is a society, where social and economic equality exist. The concept of modern state has has changed from mainly an instrument of power[112] to, so far as its internal activities are concerned, in large measure, an agency of service.[113]

108. The tax system should not be too rigid so as to rule out any modification.
109. If additional revenue is required to meet emergencies, the tax system should be able to meet such contingencies.
110. Both direct and indirect taxes should be levied. "It follows that the structure of taxation, which will be most suitable and efficacious for the purpose, is a properly diversified scheme of taxation - direct and indirect- which seeks to secure the diversion of physical as well financial resources from consumption to public investment, in forms and on a scale appropriate to the development programme". See Report of The Taxation Enquiry Commission(1953-54),Vol.1. p.149.
111. For example productivity should be preferred to equality. See generally Findlay Shirass, Science of Public Finance (1936), pp.215-225.
112. It is said that"laissez faire" has stood for a sort of legalised anarchy or game preserve in which only economically powerful could freely operate, Benjamin R. Twiss, Lawyer And The Constitution (New York,1962),p.254.
113. R.M.MacIver, The Web of Government(New York,1965),p.249.

For the purpose of the present study, the present Indian society is treated as capitalist[114] with an attempt to regulate in the general interests of public the evil effects of capitalism.[115] The main characteristic features of capitalism are private ownership of property, freedom of private enterprise, individual initiative, profit motive, wealth and competition. Regarding the right to private property, Art.19(1) (f) of the Constitution guarantees right to acquire, hold and dispose property including capital as a fundamental right to the citizens of India. Under Art.19(5) the state is authorised to make reasonable restrictions in the interests of general public on this fundamental right. Again Art.31(2) guarantees that private property will be acquired by the state only for a public purpose and also on payment of

114. Bourgeoisie and communist societies are the two division according to Karl Marx and Engels. See Manifesto of the Communist Party (Progress Publishers, Moscow), pp. 48-58.

115. The term capitalism is understood to contain the idea of private commercial enterprise operating with the minimum interference by the state.

"compensation".[116] A bare perusal of the constitutional law of India is enough to satisfy an observer that these provisions have given occasion to the judiciary in India to stultify the Government to carrying out agrarian reforms,[117] nationalization of banks[118] and abolition of privy purse payable to former princes.[119] Regarding the fundamental rights to property, it is also necessary to refer to the directive principles of state policy[120] contained in Art.39 of the Constitution of India. Under Art.39 it is the duty of the state to secure adequate means of livelihood to its citizens, to distribute the ownership and

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116. The constitutional history of compensation in India varies from full market value to an amount determined by the legislature with the Twenty Fifth Amendment of the Constitution in 1972. Whether the deletion of the word "compensation" would induce the judiciary to change the attitude is not certain, see Kesavananda Bharati v. Kerala, A.I.R.(1973) S.C.1461. Where eight judges, Sikri C.J., (p.1554) Shelat and Grover, JJ.,(p.1610) Hegde and Mukherjea, JJ.,(p.1648) Jagmohan Reddy, J.,p.(1776) Palekar,J.,(p.1824) and Chandrachud,JJ.,(p.2055) were of opinion that such amount should have some relevance to the property acquired. It is submitted that this was the position of law laid down in Vajravelu Mudaliar v.Sp.Dy. Collector, A.I.R.(1965) S.C.1017,1024 and the Constitution was amended with a view to exclude judicial review in this matter also.
117. See K.Kunhikoman v.Kerala,A.I.R.(1962) S.C.723. The Kerala Agrarian Relations Act,1961 was invalidated.
118. R.C.Cooper v. Union of India, A.I.R.(1970) S.C.564.
119. Madhav Rao Scindia v. Union of India,A.I.R.(1971) S.C.530
120. These principles though not enforceable by a court of law are "fundamental in the governance of the country and it shall be the duty of the State to apply these principles in making laws". See Art.38. It seems that the term"state"does not include judiciary(see.N.S.Mirajkar v. Maharashtra, A.I.R.(1967) S.C.1) and so it follows that the directive principles of state policy do not apply to courts and courts can have philosophies directly opposite to them! See Mathew, J., in Kesavananda Bharati v. Kerala, A.I.R.(1973) S.C.1461, 1949-1951.

control of the material resources of the community to subserve the common good, to see that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

The second characteristic of capitalism is freedom of contract. The Constitution of India as such, it is submitted, does not guarantee freedom of contract and the state is free to interfere with rights and liabilities arising from contracts in the interests of the general public.[121] Most of the control orders in respect of essential commodities are, strictly speaking, encroachments on the freedom of contract, because goods are to be sold, under many of these orders, by the dealer only to permit holders selected by the state.[122] The freedom of contract is interfered also in the field of labour welfare legislation. Another mode by which the freedom of contract has been interfered in India is by fixation of the price of commodities.[123]

Thirdly arises the freedom to carry on any trade, profession, occupation or business of one's choice and the

121. See Gammon India Ltd. v. Union of India, A.I.R.(1974) S.C. 960 where Contract Labour(Regulation and Abolition) Act, 1970 was challenged under Art.19(1)(g) unsuccessfully on the ground that the Act applied to pending contracts.
122. To begin with the courts doubted whether such dealings could be called sales for the purpose of levy of sale tax. See New India Sugar Mills v. Commr.,Sales Tax,A.I.R.(1963) S.C.1207.
123. See Premier Automobiles v. Union of India,A.I.R.(1972) S.C.1690.

freedom to appropriate the fruits arising therefrom, namely, profit motive. This is quarantsed by Art.19(1)(1)(g) of the Constitution of India as a fundamental right subject to the power of the state to impose reasonable restrictions in the interests of general public. The courts have under this provision upheld the power of the state to enact labour welfare legislations providing for minimum wages[124] and other conditions of labour.[125] The freedom of trade also includes free competition.[126] So the creation of monopoly either in favour of the state[127] or state owned corporation or a private person is an infringement of this freedom.[128] It has been observed "competitive economic activity was, in Spencer's opinion, not only the way to progress but the principle of natural justice". Art.19(6) of the Constitution of India expressly provides for state monopoly

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124. Unichoyi v. Kerala, A.I.R.(1962) S.C.12; Bijay Cotton Mills v. Ajmer, A.I.R.(1955) S.C.33.

125. See the recent decision in Mangalore Ganesh Beedi Works v. Union of India, A.I.R.(1974) S.C.1832.

126. Motilal v. Govt.of U.P., A.I.R.(1951) All.257.

127. Rajasthan v.Mohanlal, A.I.R.(1970) S.C.2068.

128. Yehoshua Arieli, Individualism And Nationalism In American Ideology (Harvard,1964)p.334.

and hence is an interference on free competition.[129] The Supreme Court of India has upheld other restrictions on freedom of trade like exclusion of middlemen[130] and canalisation of export through governmental agencies[131] as reasonable restrictions under Art.19(6).

Profit motive is considered to be the most dynamic force behind all private enterprises. Social control of profit motive has taken the form of prevention of payment of high salary, excessive bonus, and dividend, price fixation of goods etc. The fixation of price serves a dual purpose, namely, it puts a premium on excessive profits[132] and also that goods are made available for reasonable prices to the public. The courts

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129. In Akadasi Padhan v. Orissa, A.I.R.(1963) S.C.1047,1053 the court held that a law creating state monopoly need not be justified as a reasonable restriction upon the fundamental right to carry on trade. But the attempt of the Indian judiciary to uphold this right to free competition has necessitated two constitutional amendments, one in Art.19(6) and other in Art.31(2). See Saghir Ahmed v.Uttar Pradesh, A.I.R.(1954) S.C.728 where the Court held that in the case of nationalization of stage carriage routes in motor transport business compensation had to be given under Art.31(2). But recently this view has been discarded. See Amritsar Municipality v. Punjab, A.I.R.(1969) S.C.1100 for the view that the right to conduct a trade is not property.

130. Narendra Kumar v. Union of India, A.I.R.(1960) S.C.430.

131. Daruka & Co. v. Union of India, A.I.R.(1973) S.C.2711.

132. In India such controls generate black market, which in turn generates black money and tax evasion. See The Final Report of Direct Taxes Enquiry Committee (1971),p.21.

have held[133] that such prices fixed should guarantee a reasonable return to the producers in order to be a reasonable restriction under Art.19(6) of the Constitution.

Lastly remains the characteristics of free trade, which means free buying and selling. Part XIII of the Constitution of India guarantees this freedom subject to the power of the state to regulate such trade in the intdrest of public.

It follows that the Constitution of India has conferred on the government ample power of social control to regulate capital and private property. In a democracy large concentration of wealth cannot be allowed to remain in the hands of a few people. "The aspirations of this class" observes Professor G.W.Keeton[134] " requires to be satisfied by successive developments of the social services, and by financial measures which become ever increasing transfers of wealth from one section of the community to another". In modern times, though capitalism and laissez-faire stand discredited as outmoded,

133. Shree Meenakshi Mills v.Union of India,A.I.R.(1974) S.C. 366,383; Anakapalle Co.Op.Agri.& Ind.Society v. Union of India, A.I.R.(1973) S.C.734,736. But this test can be applied only in ~~xeaxx~~ relation to the most economic unit of production. Otherwise it will act as a protection to uneconomic units which should go out of business even in an open competative market. Further, even if low prices are fixed it will eventually bring down the price of the raw products and the hardship caused would be only temporary.

134. G.W.Keeton, The Passing Of Parliament(1952)(London),p.121.

in a federal setup the private property and business escaps[135] much of a social regulation at the hands of the federating states either because of the fear that the business or the industry may shift to some other state, where it is least regulated or a desire attract new commercial investments of private capital.[136]

Thus it is clear that social control regulations of police power of the state will not be able to check effectively theprivate profit making and the consequent concentration of wealth. In this respect the power of taxation steps in as a handy weapon.[137] At present the twin disasters which occur in

135. Federalism is"no more than a synonym for political and economic laissez faire". E.Mcwhinney, Comparative Federalism (2nd edn.1965), p.4. According to Lord Acton "It is the only method of curbing not only the majority but the power of the whole people". Acton,Essays on Freedom And Power(Boston,1948),p.163.
136. see Herman Finer, The Theory And Practice Of Modern Government(London,1965)p.185.
137. It has been said that the state's taxing power in general is an object of fear to capitalism. R.M.MacIver, The Modern State(Oxford,1964),p.309. According to Friedmann the power of taxation can be used to mitigate two objectionable aspects of unrestricted private property,namely, the inequalities of wealth and the power to use property for private profit without regard to community purposes. W.Friedmann,Law In A Changing Society(1959),pp.84-85. According to Herman Finer taxation is an instrument to regulate the volume and kind of production and employment and to combat depression. Herman Finer, The Theory And Practice of Modern Government (1965),p.36.

developing countries, namely, heavy taxation and inflation are present in India.[138] India being a democratic country presents another problem.[139] A democracy, it has been observed, with its general method of discussion assumed a placid society and an economic system which worked by its own momentum. The parliamentary form of democracy has certain inadequacies in coping with the present day problems of taxation. The secrecy of the budget(as no specialists are consulted),the discussion in Parliament on party lines and paucity of time are some of them.[140]

It cannot be gainsaid that India requires a complete overhauling of its tax structure. The present pattern was in-

138. It has been said"when a traditionally agricultural country progresses, three factors become visible- the pressure of expanding population against good law, the difficulty to maintain for long periods an efficient, honest and purposeful administration, and lastly the likelihood of involvement in wars whose costs outweigh the general revenue" see W.W.Rostow, Politics And The Stages of Growth (Cambridge,1971),p.29.

139. Ernest Barker, Reflections on Government(Oxford 1967),p. 172.

140. G.S.Wheat Croft,"Law,Justice And Equity in Tax" Essays in Tribute to G.W.Keeton(London,1967),pp.87-88.

inherited from the British colonial regime under the [141] Government of India,Act,1935. A simplified system of taxation on three layers, namely Centre, State and local Governments, is the need of the hour. The present scheme of distribution of the power of taxation in our federation with its over-emphasis on taxation of immovable property is old fashioned. At present all the three layers of governments impose tax on property either basing on market value, annual value or capital value. A tax assessed on property on the basis of whatever value in the ultimate analysis can be paid only out of the income from such property. That is say, the ability to pay the tax should be the criterion. Another unscientific demarcation can be found in the division of power to tax agricultural and non agricultural incomes. In India also there is a certain amount of tax evasion [142] and

141. "Indeed, the new comer to India is often struck by the extent to which the Indians, once they were independent, kept institutions introduced and developed by the British. in Governmental structure, public administration, legal and judicial systems, education and many other aspects of public affairs" H.C.L.Merillat, Land and the Constitution In India (1970),pp .37-38.

142. See Gunnar Myrdal, Asian Drama. An Inquiry Into The Poverty Of Nations(1968),pp.2098-2103. See also a reference to tax evasion in Plato. "Again, in their relations with the state, when there are taxes to be paid the unjust man will pay less on the same income, and when there is anything to be got he will get it all". See Plato, The Republic (Translated by H.D.P.Lee,Penguin Books, 1964), p.72. The knowledge of widespread tax evasion undermines morale, puts a heavy strain in tax compliance by the honest taxpayer, and undoubtedly impairs taxable capacity. See Report Of The Taxation Enquiry Commission(1953-54) Vol.1,P.151.

the distribution of taxation powers in a federation often offers twilight zones to ingenious tax evaders to shift the tax burden to be borne by people who are comparatively poor. So also the sales tax on necessary articles has contributed much to the rise in prices of such articles.

India requires a simplified form of taxation with greater emphasis on income tax- a tax on all types of income and receipts (whether agricultural, non agricultural, capital receipt or revenue receipt etc.,) a wealth tax, and a tax on estate or inheritance, apart from other duties like excise duty, customs duty and sales tax. Only by efficient taxation of income,[143] wealth and succession concentration of wealth can be prevented.

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143. Adams wrote to Thomas Jefferson"Financiers, We want more than Soldiers. The worst Enemy We have now is poverty, real Poverty in the shape of exuberant Wealth". Adams- Jefferson Letters (Ed.Lester J.Capron.1959), Vol.1 p.6

PART ONE

THE EXERCISE OF THE POWER OF TAXATION.

CHAPTER - I

THE EXERCISE OF THE POWER OF TAXATION: THE FEDERAL BASE

It is sufficient for our present purpose to state that in India the power of taxation springs from the provisions contained in Article 246 and certain entries in the Union and State Lists of the Seventh Schedule to the Constitution. The division of the taxation power between the Union Legislature and the state legislatures by way of enumeration in these two lists has avoided almost wholly, conflicts in this area. There is no concurrent field of taxation, and the residuary power of taxation vests in Parliament.[1]

The Union and State Lists of the Seventh Schedule also keep a clear-cut distinction between general legislative entries and entries relating to taxation.[2] In the Union List, entries 82 to 92 A and in the State List entries 45 to 63 deal with taxation. Hence the power to tax should be derived from a specific tax entry.[3]

It is well settled[4] that the entries in the lists are

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1. Art.248(2) and entry 97 of the Union List. See Prince Azam Jha v.E.T.Officer, A.I.R.(1972) S.C.2319,2324(the expenditure tax was held to fall within the residuary power).
2. See Venkatarama Aiyar, J., in M.P.V.Sundararamier v. Andhra Pradesh, A.I.R.(1958) S.C.468,493-494.
3. Mysore v.D.Cawasji & Co., A.I.R.(1971) S.C.152,155.
4. Rameswami, J., Harak Chand v. Union of India,A.I.R.(1970) S.C.1453,1458.

only legislative heads or fields of legislation, they demarcate the area over which the appropriate legislatures can operate and that the widest amplitude should be given to the language of the entries. It is also the duty of the judiciary to reconcile any apparent conflict between the entries by adopting a harmonious construction. For example, entry 49 of the State List authorises the state legislatures to impose "taxes on lands and buildings". One would think that an exercise of the power under this entry by the state legislatures to impose a tax on the basis of annual value of such lands and buildings would exhaust that power. But it has been held that the above tax is different from an income tax on the income from such lands and buildings and this power is exclusively exercisable by Parliament.[5] It is well settled[6] that the basis adopted for the quantification of the tax would not change the character of the tax[7] and it has been held that tax on lands and buildings on the basis of the market value would not render it a tax on the capital value of the assets, which power belongs to the Parliament.

Similarly the above entry 49 of the State List has

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5. See a decision under the Government of India Act,1935, Ralla Ram v. Province of East Punjab, A.I.R.(1949) F.C.81. The validity of Punjab Urban Immovable Property Tax Act,1940 was in issue. The Act was upheld.
6. Sainik Motors v.Rajasthan,A.I.R.(1961) S.C.1480,1484.
7. Asst.Commr.,Madras v. B.& C.Co., A.I.R.(1970) S.C.169,176. The validity of Madras Urban Land Tax Act,1966 was in issue. The Court upheld the Act.

been considered with respect to the power of the Union Legislature under entry 86 of the Union List to levy "taxes on the cappital value of the assets, exclusive of agricultural land, of individuals and companies, taxes on the capital of companies." In Sudhir Chandra v. Wealth Tax Officer,[8] it was held that the tax under entry 86 of the Union List was not directly on lands and buildings but on the capital value of the entire assets. It was held that the legislative authority was not determined by visualising the possibility of exceptional cases of taxes under two different heads operating similarly on tax payers. The same rule of construction was adopted by the Supreme Court to hold that the gift tax was not covered by entry 49 of the State List.[9]

The rule of construction that the legislative entries should not be interprected in a narrow or restrictive manner has been applied to uphold the enlargement of the definition of 'income' for the purpose of taxation to include capital gains[10] and loans taken by share-holders from a company which was not carrying on money-lending business.[11] The rule has been applied in Banarasi Dass v. W.T.O.[12] to hold that the term 'individuals' in the entry 86 of the Union List included also a hindu undivided family. In an everchanging and modern

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8. A.I.R.(1969) S.C.59, 61. The validity of the Wealth Tax Act,1957, in so far as it imposed tax on the capital value of lands and buildings was in issue. The Act was upheld.
9. Second Gift Tax Officer v. D.H.Hazareth, A.I.R.(1970) 999,1002.
10. Navinchandra Mafatlal v. C.I.T., A.I.R.(1955) S.C.58.
11. Navbit Lal C.Javeri v. K.K.Sen, A.I.R.(1965) S.C.1375.
12. A.I.R.(1965) S.C.1387.

society the past cannot rule the future and the legislative history or settled legislative practices should not be conclusive. But that does not mean that the established legal norms can be wholly overlooked to accommodate the need for revenue. For example, in Madras v. Gannon Dunkerley & Co.,[13] the Madras General Sales Tax Act,1939 in so far as it attempted by an explanation to split up an entire and indivisible building contract into a contract for sale of the building materials and for labour and construction and to tax the former, it was held to go beyond permissible limits. Previous legislative history is certainly not conclusive, but as Venkatarama Aiyar, J.,[14] observed " it is certainly valuable and might prove determinative unless there are good reasons for disregarding it.."

With respect to the residuary power of taxation the earlier[15] view of the Supreme Court was that a tax can fall under that power only if such tax is not covered by any entry in the legislative lists. This view though apparently attractive gave rise to much difficulty in the interpretation of

13. A.I.R.(1958) S.C.560. In Bhopal Sugar Industries v. D.P. Dube, A.I.R.(1964) S.C.1037 an attempt by the Madhya Pradesh Legislature to tax the consumption of goods by a dealer himself was held to be ultra vires the entry 54 of the State List. In Sri T.V.T.& B.Firm v.Comrl.Tax Officer, A.I.R.(1968) S.C.784 the explanation III to S.2 which provided that in the case of a sale by an agent there will be two sales, one by the principal to the agent and the other by the agent to the buyer where there was a transfer of the title of goods was upheld.
14. A.I.R.(1958) S.C.560,569.
15. Hidayatullah, C.J., in Second Gift Tax Officer v.D.H. Hazareth, A.I.R.(1970) S.C.999,1001 and in Hari Krishna v. Union of India,A.I.R.(1966) S.C.619,624.

entry 86 of the Union List. That entry gave power to tax capital value of assets excluding agricultural land but there was no specific entry in the State List authorising the state legislatures to levy tax on the capital value of agricultural land. In Union of India v. H.S.Dhillon,[16] it was held by the majority of the court that if the tax was not one included in the State List, then it followed that the Parliament had power to make laws with respect to that tax even though, as in this case, another entry expressly excluded it from the purview of that list.

Another rule of construction that is frequently in use in the field of tax powers is that "each general word should be held to extend to all ancillary or subsidiary matters which can fairly and reasonable be said to be comprehended in it."[17] In George Oakes (P) Ltd.v. Madras[18], the question before the Supreme Court of India was whether a seller could be assessed to tax on the amount he collects from buyers as sales tax. At first it would appear anomalous that there should be a tax on the tax. The Supreme Court held and rightly, that in the 'turnover', which was the basis of computing tax, tax

16. A.I.R.(1972) S.C.1061,1069(Sikri,C.J.).
17. Maurice Gwyer, C.J., in United Provinces v.Atiqua Begum, A.I.R.(1941) F.C.16,25; Navinchandra Maftlal v.C.I.T., A.I.R.(1955) S.C.58,61.
18. A.I.R.(1962) S.C.1037,1043(S.K.Das,J.).

collected by the dealer was also included. "The amount goes into the common till of the dealer till he pays the tax. It is the money which he keeps using for his business till he pays it over to Government. Indeed, he may turn it over again and again till he finally hands it over to Government. There is thus nothing anomalous in the law treating it as part of the amount on which tax must be paid by him".

The legislative power over taxation extends to the designation of the officers by whom the liability to tax may be enforced, the prescription of the authority, obligation and the indemnity of such officers. The legislature while imposing the tax may choose to impose the liability of the tax on persons from whom the collection of tax is most convenient. For example, ~~fram~~ as in the case of a tax on purchase of goods, the collection of tax from each individual buyer would be almost impossible. In such cases though the tax is actually levied on purchases, the seller or dealer is made liable to collect such tax and hand it over to the state. In Khyerbari Tea Co. v. Assam,[19] the validity of S.3 of Assam Taxation(On Goods Carried by Road or on Inland Waterways) Act,1961 which made the producer of tea liable for any tea carried by road or inland waters within the State even by persons other than the producer was challenged as beyond the legislative competence under entry 56 of the State List. Gajendragadkar,J.,

19. A.I.R.(1964) S.C.925.

[20] observed that it was within the legislative competence to designate suitable persons from whom tax would be collected. The court however pointed out that in such cases the decision of the legislature was not final and the court would examine to see whether there was a direct and intimate connexion or nexus between the persons so chosen and the taxable event.[21] In another decision, Rai Ramkrishna v. Bihar,[22] it was held that usually it would be inexpedient if not impossible to recover the tax on passengers directly from the passengers and so, it would be expedient and convenient to provide for the recovery of the said tax from the owners of the vehicles themselves.[23] In Byramjee Jeejeebhoy v. Province of Bombay,[24]

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20. See Ibid at 935. Here the tea produced in State of Assam was principally taken to port of Calcutta. So either the producer himself had totake it to Calcutta or the purchasers at the garden. Sarkar, J.,in his separate judgement pointed out that it would be very difficult for the State of Assam to collect tax from individual purchasers at Calcutta.Ibid at 945.
21. In Khyerbari case the Court held that the test was satisfied. Ibid at 935-936.
22. A.I.R.(1963) S.C.1667,1672. The Bihar Taxation on Passengers and Goods(Carried by Public Service Motor Vehicles) Act,1961 was upheld by the Court.
23. Other cases, are Bombay v.R.M.D.C. A.I.R.(1957) S.C.699,710 (where collection of tax on prize competition from promoters thereof was upheld); R.C.Jall v.Union of India,A.I.R. (1962) S.C.1281,1287(levy of excise duty on the consignee of coal instead of producer, was upheld); J.R.Mfg.Assn.v. Union of India,A.I.R.(1970) S.C.1589,1593.(levy of excise duty on rubber on the appellant association and not on the producer was upheld as a convenient method for collection of tax); C.S.Bureau v.C.I.T.,West Bengal,A.I.R.(1973) S.C.376,380(the demand of sales tax from an auctioneer was upheld.
24. A.I.R.(1940) Bom.65,76. An interesting argument that such imposition of responsibility to collect tax on behalf of State was violative of Art.23(2) which prohibited forced labour was rejected in Atma Ram v.Bihar,A.I.R.(1952) Pat.359,366.

Beaumont, C.J., observed that under the relevant legislative entries the legislature had power to appoint, or name any person or corporation to collect the tax levied. Where the test of rational nexus between persons on whom tax is levied and the taxable event is satisfied the only question remaining is one of administrative convenience in the collection of tax.

The legislature while levying the tax may exempt persons or transaction from such liability where it is inexpedient or uneconomical to collect tax from them.[25] The exemption given in such cases usually takes the form of graduated rate of taxation . In cases where the collection charges exceed the receipts of the tax, two courses are open to the legislature. They are, either to exempt such cases totally or[26] to levy a consolidated amount in the nature of license fee or a lump sum in lieu of tax.[27]

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25. Yet another reason for such exemption may be political.The recent move in certain states to abolish land revenue is an example. In *Travancore Rubber & Tea Co.* v. *Kerala*, A.I.R. (1964) S.C.572,574, it was laid down that the legislature was competent to lay down what all matters should be taken into consideration or left out for calculating the tax liability. Here the question was whether expenses incurred in the upkeep and maintenance of rubber plants were deductible under agri.income tax legislation.
26. *Ram Bux Chaturbhuj* v. *Rajasthan*, A.I.R.(1963) S.C.351. The provision under the Rajasthan Sales Tax Act for conditional exemption of betel leaf vendors on payment of a fee of Rs.10/- was upheld.
27. *Sainik Motors* v.*Rajasthan*, A.I.R.(1961) S.C.1480,1485.It was held that such a provision promoted easy observance as the actual assessment involved difficulties such as keeping of regular accounts etc. Such a provision was also held to be optional and not mandatory; on composition of tax see *M.Ismail* v.*Agri.I.T.O.*, A.I.R.(1964) Mad.556.

Questions of administrative convenience and expediency also play their part in the quanification of the tax which a person should pay. Generally, the tax statutes contain provisions exempting cases from the liability of tax. In Punjab v. Sewak Hotel, Bhatinda,[28] it was held that the legislature had power to exempt as well as withdraw such exemption retrospectively.

Regarding the collection of tax it has been held that the legislature can provide for demand of security from assessees for the proper realisation of tax assessed,[29] and also for provisional assessment and advance payment of tax.[30] In M.A.Rahman v.Andhra Pradesh[31], it was held that provision for registration in a sales tax legislation was an eminently reasonable provision regarding levy and collection of sales tax. It was also held that cancellation of registration was also a method of collecting the tax dues. The legislature is competent to provide for a machinery for convenient collection of tax levied. Thus it has been held that apart from the customary methods of collection of public revenue such as distraint and sale of movable and immovable property, the state can provide for collection of tax through a criminal court as if it were a fine imposed by such court.The courts have upheld provisions providing for arrest and detention of the defaulter[32]

28.(1968) 21 S.T.C.276 following Bhagwan Hotel v.Assessing Authority, Rohtak,(1964) 15 S.T.C.319(Punj.).
29. Nand Lal Raj Krishan v.Commr.of Sales Tax,Delhi,(1961) 1 S.C.R.283.
30. Ramraj Tabacco Trading Co.V.Asst.Commrl.Tax Officer,A.I.R. (1957) Mad.325,330.
31. A.I.R.(1961) S.C.1471,1473.
32.Collector of Malabar v.Erimmal Ebrahim Hajee,A.I.R.(1957) S.C.688.

in prison and attachment of debts due to the defaulter.[33] The legislature is also competent to impose penalty and interest if the tax assessed is not properly paid.[34]

The legislature has been held competent to provide for realisation of arrears of tax from the transferee where the assessee transfers his business assets before payment of tax[35] and to assess and realise tax from the agent of a non-resident assessee living outside its jurisdiction.[36]

In Burmah Construction Co. v. Orissa,[37] it was held that the legislative power with respect to ancillary matters extends to legislate for grant of refund of money illegally collected by way of tax. The court followed an earlier decision in Orient Paper Mills v. Orissa,[38] where a provision of Orissa Sales Tax Act, 1947 which restricted the right to claim refund to actual buyers was challenged as being unconstitutional and the Court observed "the competence of the legislature in this behalf is not canvassed by the counsel for the assessees".[39]

The ancillary and incidental power under the respective legislative entries extend to enact provision to check the evasion of tax. In Balaji v.I.T.O.,[40] a provision of the

33.Muralidhar v. I.T.O., A.I.R.(1960) Ass.76.
34.Chaturbhai M.Patel v. Union of India, A.I.R.(1960)S.C.424.
35.Bibhash Chandra v.West Bengal,A.I.R.(1963)Cal.578,580.
36.Premier Automobiles v.S.N.Srivastava, A.I.R.(1970) S.C.1386; A.A.D.Marzook v.C.I.T.Madras,A.I.R.(1958) Mad.1.
37.A.I.R.(1962) S.C.1320, 1322. The validity of S.14 of the Orissa Sales Tax Act,1947 was in question.
38.A.I.R.(1961) S.C.1438.
39.Ibid at 1440 (Shah,J.). (40).A.I.R.(1962) S.C.123,125.

Income Tax Act,1922 which provided for inclusion of the income of an assessee's wife and minor children in his total income was upheld as a provision calculated to prevent evasion of tax. In Baldeo Singh v. C.I.T.,[41] another provision of the old Income Tax Act which authorised the income-tax officer to impose super tax in cases where a private corporation distributed less than 60% of its total income as dividend as a measure to prevent avoidance of tax was upheld.The same view was taken where the Indian Income tax Act included any loan or advance to a shareholder to the extent of accumulated profits,[42] and the distribution of accumulated profits on the reduction of share capital[43] in the definition of dividend.

The power to check evasion of tax extends to legislative provision regarding reopneing the assessment subsequently,[44] for search of business premises, account books and seizure[45] of the same.[46] It has been also held that the legislature of a state can provide for check posts at state boundaries or demand railway ~~previde~~ authorities not to transmit goods outside the state without a despatch certificate that sales tax has been paid.[47] Recently the Supreme Court held that

41. A.I.R.(1961) S.C.736,742(S.23A(1) of Income Tax Act,1922 was under challenge).
42. Navanit Lal C.Javeri v.K.K.Sen,A.I.R.(1965) S.C.1375,1382.
43. Punjab D.Industries v.C.I.T., A.I.R.(1965) S. C.1862,1866.
44. Pooran Mal. v. Director of Inspection,A.I.R.(1974)S.C.348.
45. Board of Revenue v.R.S.Jhaver, A.I.R.(1968) S.C.59,64-65.
46. K.S.Papanna v.Dy.C.T.O.,19S.T.C.506(A.P.).
47. Hans Raj Bagrecha v.Bihar,(1971) 1 S.C.C.59. Such a provision in so far as it affected inter-state trade was held ultra vires the state legislature.

goods seized at such check posts could not be confiscated as all such goods could not be presumed to have been sold inside the state and as such not incidental to the power to tax sale in <u>Check Post Officer</u> v. <u>K.P.Abdulla</u>[48]. In an earlier case <u>Board of Revenue</u> v. <u>R.S.Jhaver</u>,[49] the question whether a state legislature can provide in its sales tax law for confiscation of unaccounted goods was left open. It is submitted that in scrupulously avoiding a decision on this general question the Supreme Court fell into an obvious error. The first schedule to the Madras General Sales Tax Act made only certain goods, taxable on the point of first sale. The large majority of goods which were outside the schedule were taxable at all points. The first sale is the sale by a manufacturer or an importer inside the state. Though the decision may be correct so far as goods mentioned in the first schedule are concerned, it is doubtful as to other goods which are taxable at all points.

The incidental or ancillary powers have to be exercised in aid of the main topic of legislation.[50] It has been held[51] that provisions calculated to check the evasion of tax or make it unprofitable will naturally have to be commensurate with the exigencies, ingenuity and contrivance of tax evasion.

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48. A.I.R.(1971) S.C.792.
49. A.I.R.(1968) S.C.59,65. But the provision was struck down as the Act contemplated tax only on sale, and taxation without sale was held to be repugnant to the scheme of the Act. Followed in <u>Hiralal Chhanganlal</u> v.<u>Rajasthan</u>, A.I.R.(1968) Raj.188.
50. See Wanchoo .J.,in <u>Abdul Quader</u> v.<u>S.T.,S.T.O</u>.,A.I.R.(1964) S.C.922,924.
51. <u>R.S.Jhaver</u> v.<u>Bd.of Revenue</u>,I.L.R.(1966)1 Mad.267,288. (Veeraswami,J.)

The test to determine whether a legislative provision is an incidental matter to a tax entry was laid down in an Australian case[52] by Dixon, J., as follows" when the main or substantial subject of tax has thus been ascertained, then the question whether particular provisions directed at defining or widening the area or incidence of the tax or the liability to it or preventing avoidance or evasion or faciliating collection have in truth introduced a new or second subject must be determined by considering the natural connection with or relevance to the main subject".

The incidental and ancillary powers are not all comprehensive and are subject to certain limitations. This power cannot be used to realise any money in the hands of a person which is not payable to the state by way of tax. For example, in Poona Municipal Corporation v. D.N.Deodhar,[53] an attempt to retain 10% of the amount of tax to be refunded to the person as a tax on refund of octroi was invalidated by the Court.[54] It is well settled that the state legislatures have no power to claim amounts collected by dealers from the

52. Resch.v.Federal Commissioner's of Taxation,(1943)66,C.L.R. 198,228.

53.A.I.R.(1965) S.C.555,558.

54.Abdul Quader v.S.T.O.,A.I.R.(1964) S.C.922;followed in S.T.O. v. Tata Oil Mills,A.I.R.(1975) S.C.1991; Uttar Pradesh v. A.B.Mfg.Co., A.I.R.(1973) S.C.1333; Ashoka Marketing Ltd. v.Bihar,A.I.R.(1971) S.C.946.

public as sales tax on a mistaken impression that they were liable to tax. In such cases the buyers of goods from whom such amounts were collected are the persons who can claim the amount legally.[55] Another limitation is that the legislature has no power to ask the instrumentalities of the state to disregard or disobey the decisions given by the courts of law by providing that notwithstanding any judgment or order of the court, the amount collected illegally by way of tax need not be refunded till regular assessment is completed under an amendment Act.[56] But if no direction as to disobey a specific order for refund by the Court is present, the legislature may provide for the withholding of money to be refunded under an order of court until an appeal pending in a superior court is disposed of.[57]

Where a tax is found to have been levied under a valid legislation the requirement of Art.265 is satisfied. Art.265 embodies the classic adage, no taxation without representation. Though considered to be an important principle of constitutional law it may be difficult to under-stand why such a well established principle was brought

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55. On the basis of this principle such collections are treated as taxable income of the dealers under the Income Tax Act. See C.S.Bureau (P) Ltd. v. C.I.T., A.I.R.(1973) S.C.376,380. It is submitted that the State can legislate under its power over bona vacantia to realise such amounts illegally collected by way of tax.
56. Municipal Corporation, Ahmedbad v. New Shrock Spg.& Wvg. Co., A.I.R.(1970) S.C.1292,1296.
57. A.P.R.T.Corporation v. C.I.T.,(1975) Tax.L.R.857(A.P.).

into the constitutional document. In India before the advent of the Constitution many a customary impost[58] was levied and collected though they were not supported by legislative fiat. The remnants of these have come up before the courts for scrutiny even after the Constitution. In Kabmosan Tangkhul v. Simirei Shailei,[59] the custom was to render a day's free labour to the village headman in every year or to pay him Rs.50/- in lieu thereof. The custom prevailed from time immemmorial. It was held that the amount collected was in the nature of tax and offended Art.265. Recently the Madras High Court in Guruswami Nadar v. Ezhumalai Panchayat,[60] held that a customary levy on all goods brought into or taken out of,[61] the village was violative of Art.265.[62]

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58. In Radha Prasad Sinha v . Dinanath Missir, ~~A.I.R.(1918)~~ A.I.R.(1918) Pat.388 it was held that the customary levy involved in that case was as old as 1865 and that a custom that prevailed for such a long period could not be contrary to public policy.

59. A.I.R.(1961) Mani.1.
60. A.I.R.(1968) Mad.271.(Alagiriswami,J.)
61. Even the State Legislature under entry 52 of List II to Seventh Schedule to the Constituion is incompetent to levy a tax on goods taken out of a local area.

62. Prior to the Constitution the land revenue in India was treated as rent and not tax, levied by virtue of the prerogative right. See Venkatarama Aiyar, J.,in Collector of Bombay v. Nusserwanji Rattanji,(1955) 1 S.C.R.1311,1323.

Where the tax imposed is not authorised by the law which confers the power, Art.265 is infringed. For example, where the statute conferred the power to levy toll only on vehicles entering municipality, a vehicle plying inside the municipal area could not be taxed[63] or where the tax was on the goods imported into or exported out of the local limits, the authority could not tax goods in transit.[64] So also where the authority imposed a tax prohibited by statute[65] or where a wrong basis for assessment of tax was selected.[66] The same result follows where the authority frames rules or bye laws under the power conferred by the statute. In such a case the aggrieved person can either challenge the rule as being beyond the power conferred by the parent statute or as unreasonable in itself. Thus in Lokamanya Mills v. Barsi Borough Municipality,[67] Rule 2(c) framed under

63. Manipuri Municipality v. Kanhaiya Lal, A.I.R.(1960)S.C.184.
64. Empress Mills v. Municipal Committee, Wardha, A.I.R.(1958) S.C.341.
65. Union of India v. Contonment Board, A.I.R.(1967)All.301 (the Board imposed tax on properties of Central and State) Governments though exempted by the statute); Maheshwari Prasad v. Uttar Pradesh, A.I.R.(1957) All.282(the local authority levied an income tax).
66. B.C.Banerjee v. Dist.Panchayat Officer, A.I.R.(1965) Cal. 463(building tax imposed on the basis of annual income while it ought to have been on the basis of annual value or capital value); Kastur Chand Jain v. Gift Tax Officer, A.I.R.(1961) Cal.649.(the value ofgift was ascertained on the basis of method laid down in Wealth Tax Act to calculate the value of net wealth).
67. A.I.R.(1961) S.C.1358.

S.58(j) of Bombay Muncipal Boroughs Act,1925 was challenged as ultra vires the parent statute. Under the statute the house tax could be levied on the basis of capital value or annual letting value, but under the impugged rule such tax was to be imposed on the basis of floor area of the building. The rule was struck down. In Pipri Village Panchayat v.Zila Parisad, Nagpur,[68] a rule prescribing period of limitation for filing appeal from the assessment of tax was declared unreasonable as that period was found to expire even before the cause of action for appeal arose in certain cases. The unreasonableness of a piece of delegated legislation is considered to be an independent ground of attack.[69] Taxing statutes have been held to be unenforceable for absence of specification of the authority to charge the tax[70] or machinery for collection of tax.[71] A tax though legally imposed could not be collected from the assessee in an unlawful method.

68. A.I.R.(1967) Bom.283. In a pre-constitutional case Raghavalu Naidu and son v.Corporation of Madras, A.I.R. (1930) Mad.648 a bye law, which required an 'exporter' of goods outside the Corporation limits to apply for refund before 48 hours of such export, was held to be unreasonable.
69. The power of court is considered to follow from the decision in Kruse v. Johnson,(1898) 2.Q.B.91. The earliest Indian case on this point is Emperor v. Balakishan,(1902) I.L.R.24 All.439. Both these are not decisions concerned with taxation.
70. M.K.Thangal v. Kerala, A.I.R.(1971) Ker.65,75.
71. E.A.Thoman v. R.T.O.,Ernakulam,A.I.R.(1969) Ker.180,142; Mariappa Nadar v. Madras, A.I.R.(1962) Mad.290,292.

An important issue which arises under this chapter is whether an invalid tax could be challenged after the lapse of some time at the time of collection. Where the taxing statute itself is ultra vires the Constitution it is well settled that lapse of any number of years would not make it legal even by acquiescence.[72] But where it is a case of an individual assessment of tax, the statutes generally provide for appeals, revision and a finality clause excluding challenge by any other method. Though this would not affect the original writ jurisdiction of High Courts[73] under Art.226, the courts have taken the view that it is better for a assessee to pursue the alternative remedy provided in the statute itself than rushing to the court directly.[74] But finality does not mean legality and it is submitted that the better view seems to be that the legality of a tax could be challenged even at the point of collection of tax.[75]

72. See Gopal Narain v.Uttar Pradesh, A.I.R.(1964) S.C.370; Amalgamated Coalfields Ltd. v.Janapada Sabha,Chhindwara, A.I.R.(1961) S.C.964.
73. The jurisdiction under Art.32 of the Supreme Court could be invoked only when fundamental rights were violated.It has been held that a misinterpretation of a statutory provision which rendered a person, otherwise not liable to tax, liable to tax was not a matter which affected his fundamental rights in Ujjam Bai v.Uttar Pradesh, A.I.R.(1962) S.C.1621,1638.
74. Bhopal Sugar Industries v.S.T.Officer, A.I.R.(1967) S.C. 549,552.
75. See Rayalseema Constructions v.Dy.C.T.O., A.I.R.(1959) Mad.382,386.

The requirement as to a valid law as the foundation of power of taxation will not be a satisfied when the executive government which was empowered to fix the rates of tax on goods mentioned in a schedule to a statute, arrogated to itself the power to amend the schedule to add more goods.[76] So also the executive could not demand tax under rules framed by it, where the statute does not provide for such taxation.[77] The assessment orders have been set aside for the violation of principles of natural justice[78] and where the concerned officer who made the assessment had not been properly appointed.[79]

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76. Firm Ghulam Hussain v.Rajasthan, A.I.R(1963) S.C.379.

77. B.C.Banerjee v.Madhya Pradesh,A.I.R.(1971) S.C.517,520; Jabalpur Municipality v.Soorji Bhanji,A.I.R.(1973) S.C.764, 766(the Court held that the local authority could not levy an octroi duty exceeding the maximum fixed by the State Government).

78. Khurjawala Buckles Mfg.Co. v.S. T. Commr., A.I.R.(1967) All.378(a case of personal bias); Nafisa Zahara Begum v. Corporation of Madras, A.I.R.(1965) Mad.515(a case of absence of reasonable notice).

79. P.C.Maheshwari v.Zila Parishad,A.I.R.(1971) S.C.1696,1704.

CHAPTER.II

RETROSPECTIVE TAXATION

Retrospective laws are those" which decree consequences or create liabilities arising out of facts whic existed or transactions which took place before the enactmen of the laws, and which consequences or liabilities did not by law exist with respect to such facts or transactions at the time the facts existed or the transactions took place".[1] The Constitution as such does not contain any prohibition against retrospective legislation.The general principle unde lying the legislative power is that once the legislative power is conceded, the legislatures may exercise the power prospectively or retrospectively.[2] With respect to retrospective taxation it has been observed by a foreign judicial authority that the needs of the Government for revenue has hitherto been deemed a sufficient justification for making a tax measure retroactive whenever the imposition seemed consonant with justice and the conditions were not such would ordinarily involve hardship.

1.Gray,Limitations of Taxing Powers(1906),cited in Frederick A.Bellard,"Retroactive Federal Taxation"(1935)48 Har.L.Rev.592.

2.See United Provinces v.Atiqua Begum,A.I.R.(1941) F.C.16,24 Mysore v.Achiah Chetty,A.I.R.(1969) S.C.477,482.

3.Brandies, J., in Untermyer v.Anderson,(1928) 276 U.S.440, 449.

Retrospective taxation is of two types, validation laws curing certain irregularities in the imposition or collection of an existing tax and retrospective taxation simpliciter. Taxation by validation laws,(better known as healing statutes or curative acts)[4] is attempted by the legislature where an existing tax is found to be inoperative for some formal[5] as well as substantive[6] defects. Retrospective taxation simpliciter has no such nexus to the past in point of time and is one which imposes a tax on past transactions, situations or property in relation to a former period.

Where a tax is levied retrospectively it may be challenged on two grounds, namely, that by such retrospective operation the nature and character of the tax have been altered and secondly, that such retrospective taxation infringes the fundamental rights under Part III of the Constitution. Since, once a law is found constitutionally valid there is no difference on the score of retrospectivity of the law, whether the right alleged to be affected is a fundamental right or not, the application of fundamental rights to retrospective tax laws is also dealt with in this chapter.

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4. See Cooley, Constitutional Limitations (1927), p.790.
5. Khyerbari Tea Co. v. Assam, A.I.R.(1964) S.C.925,936; the Assam Taxation (On Goods Carried by Road or On Inland Water Ways) Act, 1961 was earlier struck down by the Court for absence of previous assent of the President of India.
6. See Jaora Sugar Mills v. Madhya Pradesh, A.I.R.(1966) S.C.416. The Parliament had passed the Sugarcane Cess (Validation) Act, 1961 as the levy of sugar cess imposed by certain state legislatures were found invalid for legislative incompetence.

The power to tax retroactively includes the power to levy a tax for a period at which time the legislature itself was not in existence.[7] In such cases it has to be seen whether the legislature would have been competent to impose the tax at the time when the enactment was intended to have its operation.[8] The matter came up squarely in Chandrana & Co. v. Mysore,[9] in 1957-58 the Mysore Legislature was competent to impose a 10% ad valoram tax on textiles. In 1958 the Central Sales Tax Act made any imposition of tax on textiles above 2% ad valorem illegal. Later in 1964 the Mysore Legislature imposed a tax on textiles at 10% to operate in 1957-58. The Supreme Court held that a present limitation on the Legislature did not disable it from imposing a tax while it could have imposed the tax at the period for which it has now been imposed.

The Parliament can step in where a state legislature has been found incompetent to levy a tax to impose such tax and may even provide for retrospective operation.[10] The question has arisen whether in such cases the Parliament should re-enact the whole legislation or need only provide that the state

7. Laxmi Cotton Traders v. Haryana, A.I.R.(1969) Punj.12.
8. In Hajee Abdul Shukoor v. Madras, A.I.R.(1974) S.C.1729,1735 the position was that the legislation would have required the assent of the President of India if it was enacted during the period in which it was to operate but did not require such assent at the time when it was actually enacted. It was held that such assent was not necessary for the validity of the law.
9. A.I.R.(1972) S.C.217,221.
10. Jaora Sugar Mills v. Madhya Pradesh, A.I.R.(1966) S.C.416, 421.

law shall be deemed always to have been enacted by the Parliament. In Krishna Chandra v. Union of India,[11] such a device was held to be sufficient by the Supreme Court of India.

A series of decisions have laid down the proposition of law that where a provision of the taxing statute or an assessment order[12] was held to be invalid by a court of law, the state legislature should change the law retrospectively[13] in order to get over the judicial decision. A non obstante clause in such cases would operate only prospectively and the effect of a judicial decision is not got over by merely saying that a judgement shall be deemed to be a ineffective and the interpretation given by the court would be different. This is because,[14] it was held, that a court's decision must always bind unless the conditions on which it was based were so fundamentally altered that the decision could not have been ~~given in the altered that the decision could not have been~~ given in the altered circumstances.

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11. A.I.R.(1975) S.C.1389,1394. Krishna Iyer, J.,observed that it was a convenient short hand method of legislation.
12. See Tamilnadu v.Rayappa Gounder, A.I.R.(1971) S.C.231,233. To get over the effect of a decision holding that there could not be any reassessment of escaped tax under Madras Entertainments Tax Act, 1939, the State Legislature passed Madras Entertainments Tax (Amendment) Act,1966 validating past assessments. Held, the Act was invalid as it did not cure the defect pointed out by the judicial decision retrospectively.
13. C.P.Janapad Sabha v. Central Province Syndicate,A.I.R.(1971) S.C.57.
14. Shri Prithvi Cotton Mills v.Broach Borough Municipality,A.I.R.(1970) S.C.192,198; Amalgamated Coalfield v.Madhya Pradesh, A.I.R.(1967) M.P.56,64.

Though it has been observed[15] that the Indian legislatures are not subject to any strange and unusual prohibition against retrospective legislation,[16] it has been held that the state legislatures cannot provide that notwithstanding the absence of the assent of the President of India such law shall be deemed to be valid.

The retroactive levy of a tax may be challenged on the ground that by such operation the nature and character of the tax is altered. In J.K.Jute Mills Co. v. Uttar Pradesh,[17] a retroactive levy of sales tax was challenged on the ground that such a levy deprived the assessee of his right to pass on the tax to the consumers and this was inconsistant with the true character of the sale tax. Rejecting the contention, it was held that power of the legislature to impose tax on sales was not conditional on its making a provision for sellers to collect the tax from the purchasers. Similar challenges with regard to excise duty were turned down in C.J.Patel & Co v. Union of India,[18] and with regard to tax on passengers and goods

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15. Krishna Iyer, J., in Krishna Chandra v. Union of India, A.I.R.(1975) S.C.1389, 1399.
16. Jawaharmal v. Rajasthan, A.I.R.(1966) S.C.764,771.
17. A.I.R.(1961) S.C.1534,1539; Tata Iron & Steel Co. v. Bihar, A.I.R.(1958) S.C.452,462,463.
18. A.I.R.(1962) S.C.1006,1019,1027.

were turned down in Rai Ram Krishna v. Bihar,[19] and it seems doubtful whether such a contention that the retrospective operation has competely altered the character of the tax so as to take it outside the competence of the legislature will succeed in case of any kind of tax. But situations may arise where it may be difficult to give a simple and ready answer. For example, every tax has to essential elements, one of revenue and the other of regulation. Where the regulatory aspect of the tax is prominent, and if such a tax is levied retrospectively, the question whether the nature or character of the tax is changed can be answered only in accordance with the view, the court may take as to whether it was a tax or a penalty. Because, where the regulatory aspect of the tax is prominent, it is probable that the court would take the view that the retrospective imposition was in the nature of a penalty and not a tax. In an Australian case Carmody v. F.C.Lovelock Pty.Ltd.,[20] this issue was presented for the decision of the High Court of Australia, Under the Customs Tariff(Dumping & Subsidies) Act, 1961, additional duty could be levied on imported goods if the Minister was satisfied that such goods were dumped in Australia[21] to the prejudice of

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19. A.I.R.(1963) S.C.1667,1674; Khyerbari Tea Co. v.Assam,A.I.R.(1964) S.C.925; Jawaharmal v.Rajasthan, A.I.R.(1966) S.C. 764,770; A.S.Karthikeyan v.Kerala, A.I.R.(1974) S.C.436,444.
20. (1970) 123 C.L.R.1.
21. The term dumping was defined as sale of goods imported at a price less than the normal price of goods and such import causes or threatens injury to an Australian industry.

Australian industry. Here the goods had been imported between May 1962 and May 1963 and the duty had been paid. The additional duty was imposed in May 1964. The Australian High Court upheld the levy as customs duty. Apart from the classification of a levy as a tax or penalty as mentioned above, a taxing statute may also provide for penalities for having done or omitted to do something such as clasification of accounts and non-registration where such registration is compulsory. In such a case, where the statute itself makes a distinction between tax and penalty, any retrospective imposition as to the later should not get the same protection as the former.

Where a tax is levied retrospectively and an assessee has reason to doubt its legality it may be challenged as infringing the fundamental rights in Part III of the Constitution.

Art.20(1) of the Constitution of India contains a general prohibition against" ex post facto laws" . Art.20(1) reads "No person shall be convicted of any offence except for violation of a law in force at the time of the commission of the act charged as an offence, nor be subjected to a penalty greater than that which might have been inflicted under the law in force at the time of the commission of the offence". It will not be correct to say that Art.20(1) applies only to criminal statutes as taxing statutes also create criminal liability by way of fine and imprisonment.[22] In Tiwari Kanhaiyalal v. C.I.T., Delhi,[23] the matter directly arose for consideration by the Supreme Court. The appellant had filed his return under the Income Tax Act,1922. Later he was proceeded against for filing false returns under the Income Tax Act,1961. Under S.28(4) of the 1922 Act if penalty had been imposed on the assessee, he could not be prosecuted later. There was no such bar under the Act of 1961. It was held that Art.20(1) would not apply as S.28(4) of Act of 1922 did not obliterate the commission of the offence. However,the court held that as S.277 of the Act of 1961 provided for a greater punishment than the one engrafted in S.52 of the Act of 1922 to that extent, the appellant was entitled to press into service the second part of Cl.(1) of Art.20 of the Constitution.

Apart from criminal offences a taxing statute may also provide for civil sanctions. In such cases the better view is that Art.20(1) has no application.When a taxing statute provides for imposition of penalty, the question arises whether the liability is one of criminal nature being for an act or omission constituting an offence or one of

22. The matter was left open earlier in Rajsthan v.Mewar Sugar Mills, A.I.R.(1969) S.C. 880;882; See M.P.Transport Co. v. Madhya Pradesh, A.I.R.(1963) M.P.339.
23. A.I.R.(1975) S.C.902; see Basu, J., in S.K.Srivastava v. V. K. &Co., A.I.R.(1970) Cal.527,531" No doubt, the bar under Art.20(1) of the Constitution extends only to 'conviction' by a court of law.

civil liability only. In P.Ummali Umma v.Insp.Asst.Commr.,[24] Mathew, J., held that penalties imposed for evading taxes create only civil liability and Art.20 (1) was not attracted.

The complaint against retroactive legislation is that it affects vested rights or already completed transactions and that too without any notice prior to the legislation. Thus the courts began to examine such laws under Art.19 to see whether they impose any unreasonable restriction on the fundamental right of the citizen to hold property or carry on trade or business.[25]

Strictly speaking, though in its effect there is no real difference between a validation act and a retroactive legislation as both attempt to reach into the past, the two should be dealt with separately. A legislation which is a retrospective taxation is inherently bad as an ex-post facto law and generally very pressing considerations such as prevention of tax evasion are necessary for this type of legislation to pass the gauntlet of judicial review. But enactments for validation of a defective levy or collection of tax are generally more leniently viewed by the courts because the legislature presumably did not suspect any

24. (1967) 64 I.T.R.669; Indra & Co. v. Union of India,(1967) 64 I.T.R.664 the Rajasthan High Court left the point open as the Court found penalty under the new Act had been decreased; See Raghunandan Prasad v.I.T.A.Tribunal,A.I.R.(1970) All.620,624,635.
25. See West Bengal v.Suboodh Gopal, A.I.R.(1954) S.C.92.

incompetence or defect when it originally lanuched such law, but when an intervening invalidation stares it in the face, it steps in to bridge the gap to avoid an otherwise resulting chaos.

Retrospective tax laws, as described above are rarely enacted by legislatures. In Ramji Lal v. I.T.O., Mohindergarh,[26] the Patiala Income Tax Act was extended to Nabha on 11.9.1948 by a notification and the residents of Nabha State were called upon to file returns of the income of the previous year ending on 12.4.1948. Whether this would be enough to call the case one of retrospective operation is far from clear, because income tax legislation always attempts to tax income which arose in the previous year.[27] But even so in this case the Act was extended to Nabha only with effect

26. A.I.R.(1951) S.C.97,100 .See another example in Ghattaram Horilram Ltd. v.C.I.T.Bihar,A.I.R.(1955) S.C.619,623 where at first the assessment order against the company was set aside on the ground that Finance Act,1939, was not extended to Chhota Nagpur area though Indian Income Tax,1922 was in force there. Subsequently the Finance Act, 1939 was extended retrospectively in 1942. The action was upheld on the view that Finance Act was related only with quantification of tax and not with charge of income tax. See Lord Thankerton in Maharajah of Pithapuram v.C.I.T. Madras, A.I.R.(1945) P.C.89,90-91.

27. cf.Union of India v.Madan Gopal Kabra,A.I.R.(1954) S.C.158.

from 11.9.1948 and such a law could have only a previous year 11.9.1947 to 10.9.1948. Apart from that, the facts of the case show another matters also. The existing rates at the date of extension were increased later on 2,2.1949 and the residents of Nabha had to pay tax on these rates on the income for previous years commencing from 13.4.1947.[28] The Court held that no question of violation of fundamental rights of the petitioner arose in the case and for violation of Art.265 no petition would lie under Art.32 of the Constitution of India. Probably the case was only concerned with a question of interpretation of relevant notifications to see whether they were retrospective or only prospective in operation and if that be so, it presented no question as to violation of Part III of the Constitution of India.

In Union of India v. Madan Gopal Kabra,[29] the question considered was whether under the Indian Income Tax Act,1922 which was extended to the Province of Rajasthan only in 1950 income of the previous year 1949-1950 of the income earners could be taxed. It was held that it presented no question of retrospective operation though it might affect acts done in the past. The Act was held to act only prospectively though it covered income that had accrued before the Act came into operation.

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28. That is for two previous years viz.13.4.1947 to 12.4.1948 and 13.4.1948 to 12.4.1949.
29. A.I.R.(1954) S.C.158.

In none of these earlier cases the reasonableness of such a tax measure in relation to the fundamental rights under Art.19(1)(f) and (g) was considered. In C.J.Patel v. Union of India[30], such a grievance was raised. The facts of this case were as follows. In 1951 a finance bill with proposals to levy an excise duty on tobacco at the rate of 8 annas per pound and on biris at the rate of 6 annas 9 paise was introduced in Parliament. A declaration was made to that effect under Section 3 of Provisional Collection of Taxes Act,1931 and the same was made payable from the date of the introduction of the bill in parliament. But later when the Finance Act,1951 was passed, the levy of excise on biri was wholly abandoned and the levy on tobacco was increased from 8 annas to 14 annas per pound. The grievance of the appellant was that the duty was demanded at the increased rate for a commodity which he had already sold and if he was compelled to pay the levy he would have to pay it from his own pocket as he could not pass the liability over it to the consumer

30. A.I.R.(1962) S.C.1006,1022,1023; in Pithapuram T.T.C. & S.M.Union v.State,A.I.R.(1958) A.P.558 Subba Rao, C.J. and Jagamohan Reddy, J.,held at 563-564 that if a retrospective tax law had the effect of imposing restrictions which were unreasonable and could not be justified under Cl.(6) of Art.19 they could be successfully questioned as being unconstitutional.

public.[31] The Supreme Court upheld the levy[32] as it was found that the appellant could realise the sum from his vendee by virtue of Section 64-A of the Sales of Goods Act,1930. It was observed that mere retrospectivity in the imposition of tax could not render the law unconstitutional on the ground of its infringing rights under 19(1)(f) and (g).[33] Kapur, J.,[34] in a separate opinion concurred with the majority holding that Art.19 did not apply to taxation laws.

In Ayodhya Nayadu v. Madras,[35] the Madras Motor vehicles Taxation(Amendment) Act,1962 which was passed on 6-9-1962 increasing the rate of tax was made applicable from 1.7.1962. The main challenge was whether the tax levied

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31. Such inability to pass over the liability did not change the character of the tax. Ibid at 1014.
32. Ibid at 1018. Ayyangar, J., for the majority. Kapur J., concurred at 1028.
33. Ibid at 1022. According to his lordship in that case the inability to pass over the burden of the levy to the consumer public was the additional requirement to bring the case within the reach of Art.19(1)(f) and(g).
34. Ibid at 1035-1036.
35. A.I.R.(1965) Mad.349.(Veeraswami,J.). An earlier case is Bihar Cotton Mills v.Union of India, A.I.R.(1956) Pat. 131,133 where Dhoties(Additional Excise Duty)Ordinance, 1953 levied a tax on dhoties'packed' by mills in excess of quota fixed. But when later a regular Act replaced this Ordinance the incidence of tax was changed to dhoties " issued out" of the mills in excess of the quota instead of'packed' as was in the Ordinance.The legality under Art.19 was however not examined and the levy was upheld as the Court did not find any prohibition against retrospective taxation in the Constitution.

was confiscatory in character[36] and the question whether the retrospective operation violated rights under Art.19(1)(f) and (g) was not considered.

The general presumption regarding retrospective taxation is that the legislature would not attempt to reach into the past without any relevant nexus and only in a case of arbitrary exercise of such power the court need step in.[37]

On the contrary, taxation by validation acts stands on entirely different footing. Here the assessee could have anticipated the tax irrespective of the defect in its levy and cannot complain about hardship. In Tata Iron and Steel

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36. This, the Court found to be not true as the petitioner was shown to have an income of Rs.1200/- a year even after deducting various taxes! A.I.R.(1965) Mad.349,351.

37. The law in U.S.A. on this point is not very clear. But retrospective inheritance tax or gift tax when the rights of one party have been completely transferred to another has been held to offend the due process clause. Nicholas v. Coolidge,(1927) 274 U.S.531, 542-543. Willis, Constitutional Law(1936),p.639.

Co. v. Bihar,[38] the State Government by oversight did not bring the charging section of Bihar Sales Tax Act,1947 into force though all other provisions of the said legislation were brought into force. This defect was later rectified by a legislation which retrospectively amended the Act. Here also the main challenge was that sales tax could not be retrospectively imposed and this was rejected. The Act was not challenged as violative of Art.19(1)(f) & (g).

In Rai Ram Krishna v. Bihar,[39] the facts were as follows. A tax on passengers and goods carried by public vehicles was imposed by the Bihar Finance Act,1950. This tax was held unconstitutional. It was imposed without compliance with the proviso to Art.304(a) of the Constitution as was held necessary on similar circumstances in Atiabari Tea,

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30.A.I.R.(1958) S.C.452,462-463. In J.K.Jute Mills v.Uttar Pradesh,A.I.R (1961) S.C.1534. The State Government issued a notification under S.3-A of U.P.Sales Tax Act 1948 on a day prior to the coming into force of that section.This defect was pointed out in Adarsh Bhandar v. S.T.O.A.I.R. (1957) All.475 and remedied by a Validation Act. The Supreme Court only examined the power to pass a retrospective sales tax legislation and the Act was upheld. In Gopinathan Nair v.Palode Panchayat, A.I.R.(1969) Ker.43,44 the local authorities attempted to collect entertainment tax with out framing bye laws and this was remedied by T.C.Entertainment Tax(Validation of Levy and Collection) Act,1955. It was held that in view of Ramjilal v.I.T.O.,A.I.R.(1951) S.C. 97 a tax law could not be challenged under Art.31 and the Act was upheld under Art.265 as the Court found in favour of legislative competency.

39.A.I.R.(1963) S.C.1667. See also Krishnanmurthi & Co.v. Madras,A.I.R.(1972) S.C.2455 (a retrospective tax for more than an year at an increased rate was upheld); A.S.Karthikeyan v.Kerala,A.I.R.(1974) S.C.436; Srikantiah v. R.T.A.,Anantapur,A.I.R.(1971) S.C.1705

[40] Co. v. Assam. In order to get over the effect of this decision the Bihar Legislature enacted Bihar Taxation On Passengers and Goods(Carriage by Public Service Motor Vehicles) Act,1961 validating the levy from 1950 onwards. ~~When the case came before the Supreme Court again challenging the validity of the validation Act in so far as it attempted to levy from 1950 onwards.~~ When the case came before the Supreme Court again challenging the validity of the validation Act in so far as it attempted to levy the tax retrospectively, it was pointed out that the tax had to be collected from the passengers and persons who sent goods in the past and it was impossible to realise the tax at this time after the lapse of ten years. It was pointed out that the High Court had granted an interim stay of collection of tax when the case was pending before the High Court and that is was illegal to demand tax for that period. Lastly, it was contended that after the Supreme Court struck down the Act on December 12,1960 there was no legislation whatsoever till the validation Act which came into operation only on September,23,1961 and that it was unreasonable on the part of the Legislature to levy a tax for this interim period at least.

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40. A.I.R.(1961) S.C.232. The Bihar Act was subject to an appeal to the Supreme Court(C.A.No.53 of 1952) and was held invalid.

Rejecting all these contentions the Supreme Court held that the length of time(in the present case ten years) could not be a decisive test to determine the unreasonableness of a retrospective levy under Art.19(1)(f) and (g)[41]. It was held that the operators had notice of the tax and could have obtained the amount from the passengers and persons who sent goods and no question of absence of notice of the levy arose in the case to make it an unreasonable restriction. Regarding the other contentions it was held[42] that it would be inappropriate to examine the validity of the retrospective operation with reference to particular periods of time. In respect of the period for which the High Court had stayed the operation of the Act, the Supreme Court held that the petitioners therein had undertaken to collect the tax. Even otherwise such interim orders lapse when the pending case is disposed[43] of. But the Court refused to countenance the argument that the retrospective levy for the interim period ie., the period

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41. See A.I.R.(1963) S.C.1667,1675; See Asst.Commr.Madras v. B & C.Co., A.I.R.(1970) S.C.169,180-181.
42. Ibid at p.1676.
43. cf. M.A.Rahman v.Andhra Pradesh, A.I.R.(1961) S.C.1471 where the petitioner earlier obtained a stay from the High Court regarding collection of tax and in fact he also did not collect the tax from customers. The High Court later dismissed the petitions and he was held liable for tax even for that period.

between the date on which the Supreme Court struck down the levy as unconstitutional and the date of new enactment, was an unreasonable restriction on petitioner's fundamental rights under Art.19(1)(f) and (g).[44]

In Epari Chinna Krishna Moorthy v.Orissa,[45] the validation Act was passed to get over the effect of an interpretation put by the Orissa High Court on a notification which exempted, manufactures of gold from the liability to pay sales tax when they sold gold ornaments separately for value of charge and cost of manufacture. The Orissa High Court interpreted this notification to include persons like the petitioner who got the ornaments manufactured by artisans. The validation Act clarified the meaning of the term manufacturer to mean artisans alone. The validation Act was challenged as unreasonable restriction on petitioner's fundamental right under Art.19(1)(f)and (g).[46] It was held

44. The test laid down in a decision of U.S.Supreme Court by Stone, J.,in Welch v.Henry ,(1938) 305 U.S.134,147 is whether the assessee could have anticipated the tax in those circumstances.

45. A.I.R.(1964) S.C.1581.

46. Ibid at 1585. How the court came to such a finding is interesting as the original notification was in 1949 and the validation Act was in 1961. See also M.L.Aggarwal & Sons v.Asst.Commr.Sales Tax, A.I.R.(1971) All.1,9.

that the retrospective operation was not spread over a long period. Reiterating the principle that mere retroactive operation by itself was not violative of Art.19(1)(f) it was held that the petitioners had failed to prove that they did not collect sales tax in fact in the past years and thus the element of prejudice which would have brought the legislation within the ambit of Art.19 was absent, and the law was upheld.

It is submitted that the judicial scrutiny in this area is highly superficial. The Court has not given sufficient reasons to uphold, really retrospective tax laws as in these two last mentioned cases, the law operated for a period when the tax was not legally due. In such cases there was no valid notice to the tax payer of his liability and in such cases very pressing considerations other than mere augumentation of revenue of the state, eg., prevention of evation of tax, are necessary to sustain such a levy.

CHAPTER.III

THE EXTENT TO WHICH THE POWER OF TAXATION CAN BE DELEGATED.

The delegation of legislative power to the administration has been described as the "dynamo of the modern social service state"[1]. It is not directly pertinent to our subject to go into the reasons of the increasing trend for delegation of legislature power[2]. The origin of the doctrine that a legislature should not delegate the legislative power vested in it is usually traced to follow from a strict adherence to the principle of separation of powers[3].and to the doctrine of delegate potestas nonpotest

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1. Louis L.Jaffe,"An Essay On Delegation of Legislative Power II" (1947) 47 Col.L.Rev.561,592.

2. "The increasing complexity of modern administration and the need for flexibility capable of rapid readjustment to meet the changing circumstances which cannot always be foreseen, in implementing our socio-economic policy pursuant to the establishment of a Welfare State as contemplated by our Constitution, have rendered it convenient and practical, may, necessary, for the legislatures to have frequent resort to the practice of delegating subsidiary or ancillary powers to the delegating subsidiary or ancillary powers to the delegating subsidiary or ancillary powers to the delegates of their choice" Dua, J., in Tata Iron & Stell Co. v. Workmen, A.I.R.(1972) S.C.1917,1922.

3. Charles De Montesquieu, The Spirit of Laws(38 Britanica Great Books), P.70; Frederick Green,"Separation Of Governmental Powers"(1920) 29 Yale L.J.369,393.

delegari[4] of the law of contract. Though these two theories have supplied an initial basis for the doctrine against delegation of legislative power, both the theories stand discredited[5] and the doctrine requires a fresh and stronger basis for its continued existence in the present day. That basis is provided by the democratic nature of the Constitution itself. In the words of Shri Justice Shah"Our Constitution makers have entrusted the power of legislation to the elected representativesof people, so that the power is exercised not only in the name of the people, but by the people. The rule against exsessive delegation of legislative authority is a necessary postulate of the sovereignty of the people"[6]. To the same effect is an observation" We must not take lightly the objection to indiscriminate and ill defined delegation, It expresees a fundamental democratic concern"[7].

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4. According to Locke "For it being but a delegated power from the people, they, who have it,cannot pass it over to other". Peter Laslett, Lockes' Two Treatises Of Government (1970, Cambridge), P.380. For criticism of this view see Hidayatullah J., In Jalan Trading Co v. Mill Mazdoor Sabha, A.I.R.(1967) S.C.691,718.
5. The doctrine of separation of powers has never been taken seriously by constitutional lawyers as existing in any system of polity. See James Madison, The Federalist, No. 47(Modern Library, New York),pp.312-320. The other maxim of delegata potestas non potest delegari is said to be a misreading by Coke of Bracton. See Willis, Constitutional Law op.cit., p.137.
6. In Delhi Municipality v. B.C.S. & W.Mills, A.I.R.(1968) S.C.1232,1264.
7. Louis L.Jaffe, "An Essay on Delegation of Legislative Power I" (1947) 47 Col.L.Rev.358,360.

So if democracy is the basis of the rule against delegation of legislative power to other bodies, it naturally follows that there cannot be much objection in delegating such powers to other representative bodies like municipalities and local authorities.[8] So far as delegation of legislative power to other non representative bodies is concerned the legislature should see that it is within limits so as not to infringe the theory of consent, which is the basis of all democratic institutions.

The theory is that essential legislative functions cannot and should not be delegated at all. This prohibition can apply only to legislative power and to the exercise of statutory discretions, and non legislative powers which are administrative or ministerial in nature may be delegated. The essential legislative power if at all has to be delegated, may be delegated only with proper checks and balances or safeguards to ensure the democratic process of legislation as far as possible.

The power of taxation, as has already been stated, is essentially a legislative power, for, Art.265 of the Constitution of India states that " no tax shall be levied or

8. This exception is based on the principle that delegation of power to such local units of self government possessing legislative body chosen by the people does not actually remove the important subject of taxation from the control of the people. See 71 Am.Juris+2d.p.468.

collected except by authority of law". An attempt is made in the following pages to trace the law of permissible delegation of legislative power in India with special reference to taxation.

Even though before the Constitution the question of vires of delegated legislation in India came up occasionally, the Privy Council in Queen v. Burah,[9] held that the Indian legislatures had plenary powers within the limits granted by the Imperial Parliament. After the Constitution the Supreme Court rejected this rule in In re Delhi Laws Act[10] case and

9. (1973) 3 A.C.889,904.
10. A.I.R.(1951) S.C.332,346. Even though rejected, this view is some times pressed before the Judges, ~~Sims~~ See for example Venkatarama Aiyar, J.,in Banarsidas Banot v. Madhya Pradesh, A.I.R.(1958) S.C.909,913; Mathew, J., in Gwalior Rayon Mills v. Asst.Commr., A.I.R.(1974) S.C.1660, 1682 and in M.K.Papiah v. Excise Commr.,(1975) 1,S.C.C. 492, 498. Recently Khanna, J., speaking for the majority observed in Gwalior Rayon Mills v.Asst.Commr., A.I.R.(1974) S.C.1660,1667 " We find ourselves unable to agree with the view, which has been canvassed during the course of arguments that if a legislature confers power to make subordinate or ancillary legislation upon a delegate, the legislation need not disclose any policy, principle or standard which might provide guidance for the delegate in the exercise of that power".

followed the constitutional doctrine prevailing in U.S.A. It is that legislature could not delegate the essential legislative function, namely, formulation of the policy of the statute and the rest of the matter may be left to the discretion and decision of the executive. It is not necessary for us to narrate fully how the search for the policy of the statute has extended from the scrutiny of the provisions of the statute[11], the preamble[12], the statement, objects and reasons to even the preamble of a statute[13]. Suffice to say that the courts have hitherto liberally construed the statutory provisions impugned before them and the standard has been made as flexible as possible to the extent of inviting criticism from brother judges[14]. However these standards laid down for

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11. See Arnold Rodricks v. Maharashtra, A.I.R.(1966) S.C.1788, 1795.
12. Vasanlal Maganbhai Sanjanwala v. Bombay, A.I.R.(1961) S.C.4 8; Madhya Pradesh v. Champalal, A.I.R.(1965) S.C.124,128.
13. Harishankar Bagla v. Madhya Pradesh, A.I.R.(1954) S.C.465,468.
14. See Subba Rao, J., in Vasanlal Maganbhai Sanjanwala v. Bombay, A.I.R.(1961) S.C.4,11, "But the said liberal construction should not be carried by the courts to the extent of always trying to discover a dormant or latent legislative policy to sustain an arbitrary power on executive authorities".

the guidance of the executive may be of a substantial or of a procedural nature. Viewing from the position of the citizen these standards may be termed safeguards. The substantial safeguards in the realm of taxation may take the form of fixing the maximum or minimum rates where power is conferred to fix any rate of tax or laying down the relevant matters which the authority had to consider while exercising such power.[15] Only in such cases one may say that the delegation is canalized and not vagrant,[16] and a mere statement of policy such as relief to tenants etc., should not be sufficient to pass the gauntlet of this test. Where such standards are sufficiently definite that will help the legislature, the court and the public to ascertain whether the administrator has conformed to those standards.[17] Moreover that will help the courts to examine whether the executive has over stepped the limits of the power delegated and to confine the executive within the ambit of the powers conferred.

The procedural standards or safeguards may take the form of provision for consultation of affected interests,[18]

15. See Union of India v. Bhana Mal Gulzari Mal, A.I.R.(1960) S.C.475,481(the power to fix fair price of an essential commodity,namely steel); Chinta Lingam v.Govt.of India, A.I.R (1971) S.C.474, 477.
16. Cardozo, J. in Panama Refining Co. v.Ryan,(1934)293 U.S. 388,440.
17. Stone C.J., in Yakus v. United States,(1944) 321 U.S.414,426.
18. Edward Mills Co. v.Ajmer, A.I.R.(1955) S.C.25,28. The Advisory Committee of minimum wages was to consist of equal number of representatives of employers and employees.

concurrence or sanction of a higher authority or of laying before the houses of legislature with affirmative or negative resolution.[19] The judgment of Wanchoo, C.J., in Delhi Municipality v. Birla Cotton Spg.& Wvg.Mills,[20] has settled the norms to be applied by the courts in examining the permissible limits of delegation of legislative power in the case of taxation by local authorities.[21] But where power is delegated without safeguards, it may be challenged as arbitrary and violative of Art.14 of the Constitution. The leading case on this point is Pannal Binraj v. Union of India,[22] where the validity of S.5(7-A) of Indian Income Tax Act,1922 which empowered the commissioner of income-tax or the Central Board of Revenue to transfer cases of particular assessees from the jurisdiction of one income-tax officer to another. Petitioner's case was transferred from Patna in Bihar to Delhi. The contention of the assessee was that the power conferred on the authority

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19. J.R.G.Mfg.Assn. v. Union of India,A.I.R.(1970) S.C.1589 1594; Western India Theatres v. Municipal Corpn.Poona,A.I.R. (1959) S.C.586,588.
20. M.K.Papiah v.Excise Commissioner,(1975) 1 S.C.C. 492, 497; J.R.G.Mfg.Assn.v. Union of India, A.I.R.(1970) S.C.1589,1595. Where the provision is for simple laying without the requirements as to affirmative or negative resolution,the court has held them to be directory in nature. Jan Mohammed Noor Mohamad Bagban v.Gujarat, A.I.R.(1966) S.C.395,394; Narendra Kumar v.Union of India, A.I.R.(1960) S.C.430,435-436.
21. A.I.R.(1968) S.C.1232.
22. A.I.R.(1957) S.C.397; See also J.R.G.Mfg.Assn. v. Union of India , A.I.R.(1970) S.C.1589; M.M.Ipoh v.C.I.T.,Madras, A.I.R.(1968) S.C.317.

was unguided, and hence discriminatory under Art.14 of the Constitution.[23] The Supreme Court observed that the convenience of the assessee was normally the main consideration in determining the place of assessment but under the exigencies of tax collection, the nature and volume of the business operation or connection with various other individuals or organizations in earning income by an assessee, it might become necessary to impose such extra territorial investigation. It was held that the discretion had to be exercised "with due regard to the exigencies of tax collection"[24] The Court observed that the statute did not lay down any rule or direction in regard to the exercise of the power.[25] The Court also stressed the necessity of following the rules of natural justice in such cases and of recording reasons for the

23. A.I.R.(1957) S.C.397,406.

24. Ibid at 408.

25. A distinction was made between a statute conferring a discretion with regard to a fundamental right under the Constitution and other statutory rights. It was held that with regard to the former the discretion must be controlled by clear words. See A.I.R.(1957) S.C.397, 410.

order of transfer.[26] But with all these caveats the Pannalal Binjraj decision, it is submitted, relies too heavily on administrative exigency or executive necessity and the pious hope[27] that higher administrative authorities would not abuse power is hardly an answer to the problem. The distinction made between a fundamental right and an ordinary statutory right in that respect is unsustainable as a wide discretionary power conferred on the executive is always capable of discriminatory application and that itself would violate the guarantee under Art.14 of the Constitution.[28]

Directing our attention to the taxing power under the Constitution, it is necessary to note that a tax law has three essential features-provisions declaring liability to pay the tax ie.the charging provisions, secondly, provisions for assessment of tax and thirdly provisions for collecting or recovering the tax including provisions for checking evasion of tax. The problem is discussed with special reference to these features.

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26. Ibid at 410 .See also Bose, J., in Bidi Supply Co., v. Union of India, A.I.R.(1956) S.C.479,488.
27. See A.I.R.(1957) S.C.397,414 " A humane and considerate administration of the relevant provisions of the Income Tax Act would go a long way in allaying the apprehensions of the assessees and if that is done in the true spirit, no assessee will be in a position to charge the Revenue with administering the provisions of the Act with "an evil eye and an unequal hand".
28. See also in this respect Glass Chatons Importers and User's Assn. v. Union of India,A.I.R.(1961) S.C.1514 where the licence to import glass chatons was canalised and issued in favour of State Trading Corporation, a government owned company, the restriction was held to be a reasonable one.

Regarding the charging sections, the declaration by the legislature of the liability to pay tax is undoubtedly, the most essential feature of a taxing statute, and could not be delegated. The maximum latitude which could be shown in this area, is the power sometimes granted to the executive to bring a statute into operation at different times in different parts of the territory. This is known as the power of conditional legislation and is not generally considered to be delegation of legislative power strictosensu.

The leading case of this point in Rajnarain Singh v Chairman, Patna Administration Committee,[29] where the validity of a notification issued by the State Government under Section 3(1) of Patna Administration Act,1915 extending S.104 of Bihar and Orissa Municipalities Act,1922 to a newly added area of the Patna Municipality was at issue.S.3(1)(f) of Patna Administration Act empowered the State Government to extend to Patna any section of the said Act subject to such restrictions and modifications as it though fit. Bose, J.,speaking for the Court[30] observed that the action of the Government in subjecting the residents of Patna village area to municipal taxation without taking up the formalities imposed upon it by Sections 4,5 and 6 of Act of 1922 viz. the provisions for giving representation to the local population, the Government,

29. A.I.R.(1954) S.C.569.
30. Ibid at 574. See Lachmi Narain v.Union of India,A.I.R.(1976 S. C.714, 727.

violated the principles of valid delegation of the power to extend legislation. Here according to the Supreme Court a vital matter of policy viz. taxation without representation was violated. It was held that no municipality with power to tax should be thrust upon a locality without giving its inhabitants a chance of being heard and of being given an opportunity to object. The decision clearly brings out the fact that if at all the legislature wants to delegate this power it can do so by empowering the executive to adopt the provisions of another taxing law and without doing violence to the normal safeguards, provided in such law. In Shama Rao v. Union Territory, Pondicherry[31], the facts were as follows: The Pondicherry General Sales-tax Act, 1965 by S.2(1) provided that "The Madras General Sales Tax Act, 1959 as in force in the State of Madras immediately before the commencement of this Act shall extend to and come into forcein the Union Territory of Pondicherry..." and S.1(2) of the Act empowered the State Government to bring the Madras Act into force on any date appointed by it. The State Government issued notification on March 1,1966 extending the Act with effect from April,1,1966. But it so happened that meanwhile the Madras Legislature had amended the Madras Sales Tax Act and it was actually the amended Act that was brought into force. The contention of the petitioner was that the Pondicherry Legislature had adopted not only the Madras General Sales Tax Act as it stood when the Pondicherry

31.A.I.R.(1967) S.C.1480.

Legislature enacted the law but also future amendments upto the time of the commencement of the Act, and thus it had abdicated the essential legislative function. Shelat, J.,[32] speaking for the majority, held that if a legislature instead of going through the full formality of legislation applied its mind to an existing statute enacted by another legislature for another jurisdiction adopted such a statute and enacted to extend it to the territory under its jurisdiction, it might be said that it had laid down a policy to extend such a statute and directed the executive to apply and implement such a statute. His lordship held that when the legislature not only adopted such a statute but also provided that the legislation applicable to its territory shall be the statute amended in future by the other legislature, such a case would amount to abdication of essential legislative function or effacement in favour of another legislature.[33]

In this case the delegation of power to bring the Madras Act into force was given to the Executive Government of Pondicherry and it was within the discretion of that body to choose a convenient date. Viewed in such a way this was a

32. The majority judgment was delivered by Shelat, J., for himself, Subba Rao, C.J., and Mitter, J., Ibid at 1487.
33. Ibid. It is submitted that in such a case also the abdication of function is in favour of the executive and not the other legislature as it is for the executive and not the other legislature to select the date of extension whether the other legislature seeks to amend the law or not. Moreover, the other legislature could not be said to amend the law by virtue of the delegated power. Hence the term "effacement" seems to be the proper term.

simple case of conditional legislation as the particular Act to be extended was chosen by the legislature itself. The whole trouble arose as the legislature provided that the Madras Act immediately before the commencement(or extension) would come into force and because of the fortuitous circumstance of an amendment occuring before such extension. Hence the only power delegated to the executive was to choose a convenient date.[34] The minority Judgment[35] left the point open and dismissed the petitions as a later amendment by the Pondicherry Legislature had retrospectively rectified that error. The majority struck down the later amendment also on the view that it was an attempt to revive a void law. It is submitted that the majority judgement on this aspect takes a very narrow view and could be approved only on the principle that in fiscal matters the practice of adopting the taxing statute of a neighbouring state might not be a wholesome practice.[36] As the minority judgment by Bhargava,J.,[37] had

34. Prior to the extension of Madras Act there was no sales tax in Pondicherry though certain similar taxes were in force under the French Regulation.The constitution of authorities under the Sales Tax Act would naturally have taken some time and this would have explained the delay that occured in extending the Act.
35. Shah and Bhargava, JJ.
36. cf. Markose and Balachandran,"The Problem of Delegation of Legislative Power in India", 1 Kerala Uni.Law Rev.101,134.
37. A.I.R.(1967) S.C.1481,1493. See Tirath Ram v. Uttar Pradesh, A.I.R.(1973) S.C.405,407 where it was held that when a subsequent legislation validated certain notifications, which were held to be bad for excessive delegation,the ground of excessive delegation was not still available for challenge as such notifications had become part of the statute.

pointed out the effect of the subsequent Amendment Act was that the Pondicherry Legislature unequivocally and in clear terms itself laid down the policy as to the provisions of the Madras Act which were to be extended to Pondicherry and were to govern the levy of sales tax in that territory.

Recently, it has been observed[38] that the principle of the ruling in Shama Rao's case must be confined to the facts of the case. However it is not clear whether the efficacy of the decision in Shama Rao's case is lost as the majority judgement delivered by Khanna, J., in Gwalior Rayon Mills v. Asst.Commr.,[39] did not over-rule it but only distinguished it.[40] It has been held that there was no general principle which precluded either the Parliament or a state legislature from adopting a law and the future amendments to the law passed respectively by a state legislature or Parliament and incorporating them in its legislation.[41] Even in U.S.A., the law on the point appears to be that "where the ultimate operation of a law is made to dpend upon the action of some foreign deliberative or legislative body, it is erroneous to suppose that there

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38. See Mathew, J., concurring along with Ray, C.J., in Gwalior Rayon Mills v. Asst.Commr., Sales Tax, A.I.R.(1974) S.C. 1660,1679. This statement was approved by a bench consisting of 3 judges(Ray, C.J., Mathew and Krishna Iyer, JJ.) in Krishna Chandra v. Union of India A.I.R.(1975) S.C.1389,1394.
39. A.I.R.(1974) S.C.1660,1664.
40. Krishna Chandra v. Union of India, A.I.R.(1975) S.C.1389,1394.
41. See 71 Am.Jur.2d.p.467

is any delegation of legislative power to such foreign body, since the law is complete and perfect when it comes from the hands of the legislature".

In Western India Theatres v. Municipal Corporation, Poona,[42] the question whether the legislature could delegate to the subordinate authority the plenary power of taxation including the power to select any particular tax was raised. Here the appellant was a lessee of four cinema houses and was required to pay a license fee of Rs.2/- per day. S.59 of Bombay District Municipalities Act,1901 enumerated specific taxes whi- which could be imposed and collected by a municipality. Cl.(xi) of S.59 read"Any other tax to the nature and object of which the approval of the Governor-in-Council shall have been obtained prior to the selection contemplated in sub.cl.(1) of Cl.(a) of section 60". The grant of such a power to impose any tax at the discretion of a municipality was challenged as a piece of excessive delegation. Rejecting the contention, it was held[43] that the power of the municipality could not exceed that of the legislature itself. The only flaw in this argument according to the present writer is that the Municipalities Act was enacted in 1901 when the Indian Council Act,1861 was in force.At that time there was no provincial or state list and provincial legislature could legislate only on transferred subjects. So it is doubtful whether such a provision would have

42. A.I.R.(1959) S.C.586.
43. Ibid at 588.

enabled the respondent municipality to impose a tax enumerated in the State List of Seventh Schedule to the Constitution of India. It was also held that S.59 authorised the imposition of a tax " for the purpose of this Act." Obligations and functions of the municipalities are set forth in Chapter VII. It was held that the taxes could be levied only for implementing those purposes and that taxes must have some reasonable relation though no direct relation to the duties cast on it by the statute.[44]

Though the power to impose a tax"for the purposes of the Act" does not generally provide for any guide-line or principle to be followed by the delegate, in the cases of local self government authorities the Supreme Court had held that it was a sufficient guideline.[45] In such cases a generally uniform procedure of passing a resolution by the council, publication of proposals of taxation, hearing of objections etc., is followed and this procedure ensures the maximum participation of people who are liable to pay the tax in the process of taxation. Hence it is submitted that decisions

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44. Ibid at 588. For example a lighting tax may be imposed as the municipality had to provide for lighting streets and a water rate may be imposed as it had to provide drinking water to the inhabitants.
45. See Corporation of Calcutta v. Liberty Cinema, A.I.R. (1965) S.C.1107,1119; M.P.Sugar Mills v.Kanpur Municipality, A.I.R. (1969) All.[illegible]3,[illegible]; Jagadish Prasad v. Saharanpur Municipality, A.I.R.(1961) All.583,589. It was held that such power when conferred on a municipality was subject to the negative check of the persons who would be directly affected by it.

dealing with the conferement of such power to local self government should be viewed differently and are not of general application.[46] For example, in N.J.Nayadu & Co. v.Nagpur Municipality[47], the validity of S.114(2)(g) of City of Nagpur Corpn.Act,1948 which authorised the respondent Municipality to impose any other tax which the State Legislature had power to impose in the State under the Constitution, was in question. As could be seen, this was the widest power conceivable in the present set up. Here the Municipality had imposed a theatre tax. The provision was upheld as (a) the local authority had to follow a detailed procedure in imposing tax,(b) it could impose tax only for the purposes of the Act and (c) there was provision for scrutiny by State Government.

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46. See Bangalore Woollen Cotton and Silk Mills Co.v. Corpn. of City of Bangalore, A.I.R.(1962) S.C.1263,1266. Here power of the Municipality was to impose octroi on certain specified goods and then provided that it could impose octroi on other articles which might be approved on this behalf,the power was upheld as conditional legislation.

47. A.I.R.(1970) Bom.59,65. The decision Mohammed Hussain v. Bombay,A.I.R.(1962) S.C.97 regarding the power of the Government to add or omit to an item in the schedule relating to agricultural produce liable to taxation by local market committee also should be understood in this light. There also the committee was a representative body of producers, traders and commission agents. See also K.N.Maruleradhya v.Mysore,A.I.R.(1970) Mys.114,129; Achchelal v. Janapada Sabha, Sihora, A.I.R.(1963) M.P.74 (F.B.) for a case where the local authority was empowered to levy any tax with the previous approval of the State Government.

The second feature of a taxing statute is provisions for assessment of tax. The word" assessment" is a term of varying import. This word is sometimes used to mean the computation of the amount of tax and at other times to mean the whole procedure laid down for imposing the liability on tax payers.[48] The term assessment is used here in the latter sense and comprise the provisions relating to the subject matter of taxation, the rate of tax, the basis at which the quantum of tax is to be arrived at and the authorities for enforcing the tax liability.

Generally speaking, the subject matter of taxation, namely, persons, property or goods, have to be specified by the legislature itself.[49] For example, in an income tax legislation what sort of income has to be taxed is a question of policy to be decided by the legislature itself and not to be left to the executive. But this general rule has very fine limitations. For example, in a sales tax legislation if the legislature defines the term"sale" and provides for tax on sale of goods, the subject matter of taxation namely the liability of all goods to taxation when their sales occur within the state could be said to be specified. But being a fiscal legislation, a lot of exemptions and concessions

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48. See Dy.Comml.Tax Officer v. ShaSukraj,(1963) S.C.67,69.
49. According to Cooley the non delegable powers included the selection of the property to be taxed, the determination of the purpose for which taxes shall be levied, fixing of the amount of tax to be imposed and fixing of the rate of taxation in general. Cooley, The Law of Taxation,op.cit., Vol.1.P.194.

would have to be given to avoid hardship and normally a power to exempt persons or property in particular circumstances is confered on the executive government. The question whether such power would be bad for excessive delegation is also to be examined here.

It may be said that where a taxing statute is clear in its ambit or filed of taxation, the power to select the incidence of taxation may be delegated to the executive to check the evasion of tax.[50] In M.M.Ipoh v. C.I.T.,Madras, S.3 of Income Tax Act, 1922 which authorised the income tax officer either to assess the income of an association of persons collectively or in separate shares in the hands of the members of the association was challenged as unconstitutional. Rejecting the contention Shah, J., held that[51] though S.3 did not lay down any policy for the guidance of the income tax officer,

50. A.I.R.(1968) S.C.317. The decision was handed over under Art.14 as the contention was that such a power was arbitrary and capable of use for discrimination.
51. Ibid at 321-322; see Rangaswami Chettiar & Co. v.Madras, A.I.R.(1957) Mad.301. S.3 of Madras Sales Tax Act empowered the State to determine the criterion for goods whose turnover had to be assessed in the hands of the seller and those in the hands of the buyer. Upholding the validity of the provision it was held that in such determination the economic effects of the tax on the consumer as well as its assistance to export trade had to be considered and this was held to be matter to be decided by the executive government.

such guidance could be garnered from other provision of the Act, its scheme, policy and purpose and the surrounding circumstances which necessitated the legislation. It was held that for diverse reasons assessment of income of the association might not be possible or that such assessment might lead to evasion of tax and in such cases it would be open to the income tax officer to assess the members constituting such association. The same principle was followed in J.R.G. Mfg.Assn. v. Union of India,[52] where S.12(2) of Rubber Act, which authorised the Rubber Board to collect the tax either from the producer or from the manufacturer of rubber products, was challenged as a piece of excessive delegation laying down no guiding principle. Upholding the validity of the section, Grover, J., speaking for the court hold that the attempt to collect the levy from producers had led to much evasion of tax as the Board could not get in touch with the vast number of producers. The manufacturers were few in number and collection of tax from them was comparatively easier.

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52. A.I.R.(1970) S.C.1589. There was also a challenge under Art.14. The safeguards which existed in the present case were that(1) the Rubber Board was a representative body of rubber producers and manufacturers,(2) the Central Government had over all controlling power over the activities of the Board and (3) the tax had to be levied in accordance with the rules framed by the Central Government and such rules were to be laid before the houses of Parliament.

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In the light of these decisions, the decisions of Kerala High Court in Standard Motor Union v. Kerala,[53] in which S.12 of Travancore Cochin Motor Vehicles Act was struck down as a piece of excessive delegation seems to be wrong. There the said section authorised the Government to levy a toll tax if satisfied that there existed special circumstances and it was held that the statute gave no guidance as to what circumstances could be considered as special circumstances.

The other details of assessment procedure which could be delegated depend on the particular circumstances of the case and the provisions of the particulars statute.

In Hira Lal v. S.T.O. Kanpur,[54] Section 3 of U.P. Sales Tax Act had authorised the State Government to select certain goods for the purpose of imposing tax on the point of first purchase inside the State. Upholding the validity of the section, it was held that such selection required consideration of economic impact of the levy on the society, economic consequences and administrative convenience etc.,and that the executive was the proper authority to do that. In Ram Sahai v. Commr. Sales Tax,[55] it has been held that what amounted to a

53. A.I.R.(1962) Ker.298,308.

54. A.I.R.(1973) S.C.1034,1041; Goenka Mica Co. v. Bihar,(1975) Tax L.R.1277(Pat.).

55. A.I.R.(1964) All.176,178.

turnover or what transactions were to be included in a turnover was one matter and how the amount of a turnover was to be determined or worked out was a different matter and that the legislature could validly delegate only the letter and not the former. In Maud Tea & Seed Co. v. Agri.I.T.O., Shillong,[56] S.59 of Income Tax Act,1922 empowered the Central Board of Revenue to prescribe the manner and procedure by which income derived in part from agriculture and in part from business was to be ascertained. This was because under the Constitution income from agriculture was exclusively taxable by state governments. It was held that it was a matter of detail which could be left with the executive with impunity.

In V. Nagappa v. Iron Ore Mines Cess Commr.,[57] the Iron Ore Mines Welfare Cess Act,1961 had provided for a levy

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56. A.I.R.(1970) Ass.& Nag.61,70. In Firm Ragubar Dayal v. Uttar Pradesh, A.I.R.(1955) All.653. Itwas held that the delegation of power to the State Government to select goods which should be liable to single point of taxation and to fix such points for different goods under the U.P. Sales Tax Act was upheld as a matter of administrative detail only.

57. A.I.R.(1973) S.C.1374,1379: In Syed Mohamed & Co. v.Madras, (1952) 2 M.L.J.598,606 the power conferred on the State Government to decide whether the seller or the purchaser had to be taxed under the Sales Tax Act was upheld.Under the Madras Act, such rules framed by the Government had to be laid before the legislature and would have become operative only on approval.

of excise duty on iron ore to meet the expenditure incurred in connection with promotion of welfare of labourers employed in that industry. The Act had conferred the power to bring this levy into operation with such rate not exceeding 50 p., on the Central Government and this was challenged as bad for excessive delegation. The Court rejected the contention as the purpose of the levy had been specifically stated in the statute itself and the maximum rate had been fixed.

Regarding the power to give exemption[58] from the operation of a taxing statute the problem is not capable of a simple answer. In Banarasidas Bhanot v. Madhya Pradesh,[59] the Supreme Court was concerned with the case of cancellation of an exemption already given. Under the C.P. and Berar Sales Tax Act,1947 goods sold to and sold by Government were exempt from sales tax. Later the State Government by a notification under S.6(2) of the Act cancelled the exemption given to goods sold to the State Government. Under S.6(2) the State Government was empowered to amend the schedules to the Act, relating to the rate of tax[60] and that relating to exemptions from tax after giving not less than one months notice.[61] The case was in fact

58. For general principles see P.J.Irani v. Madras, A.I.R.(1961) S.C.1731,1737-1738(not a tax case).
59. A.I.R.(1958) S.C.909; see Corpn. of Calcutta v. Liberty Cinema,A.I.R.(1965) S.C.1107,1117. (Sarkar, J., that Banarsidas case was one "where the question was on what subject matter, and therefore on what persons, the tax could be imposed".)
60. This aspect is discussed later in detail.
61. This was probably to invite objections from affected parties.

decided on the view that since the transaction involved was a works contract, it could be subjected to sales tax only if an agreement of sale of materials could be spelled out and not if it was an indivisible contract.[62] This would have been sufficient to dispose of the case,[63] but the majority[64] of the Court thought that as there might be transactions which would not fall within the prohibition in Gannon Dunkerly & Co., case it was necessary for them to express an opinion on this point also. On the question whether the power to exempt from the ambit of a taxing statute was a matter of policy, and legislative determination was necessary for delegating such a power it was held[65] that "working of taxation laws such as the selection of persons on whom tax is to be laid, the rate at which it is to be charged in respect of different classes of goods and the like" were matters of detail to be safely delegated. It is submitted that this w sweeping observation was not warranted by the facts of the case as it would seem that the above mentioned matters could be delegated without safeguards or sufficient guidelines. It is true that a taxing statute may require a lot of adjustments to suit local requirements. But that does not mean that such a power could be arbitrarily conferred on the executive. For example,

62. See Madras v. Gannon Dunkerly & Co., A.I.R.(1958) S.C.560.
63. Bose, J., in fact refrained from expressing any opinion on other matters. See A.I.R.(1958) S.C.909,914.
64. See Venkarama Aiyar, J., Ibid at 912.
65. Ibid at 913.

in Mohd. Hussain v. Bombay,[66] regarding the power of the State Government to amend the Schedule to Bombay Agricultural Produce Markets Act,1939, it was held that the scheme of the Act was to leave out retail trade altogether and dealt with only wholesale trade. The StateGovernment, it was held, when decided to add a particular agricultural produce would have to consider in each case whether the volume of trade in that produce was of such a nature as to give rise to wholesale trade and when it decided to delete an item from the schedule it could do so if it came to the conclusion that the trade of a particular commodity had fallen and could no longer be a subject of wholesale trade. A later decision Orient Weaving Mills v. Union of India,[67] is more illustrative. Here the Central Excise and Salt Act,1944 empowered the Government to frame rules to exempt wholly or partly and the Government exempted co-operative societies producing cotton from excise duty.[68] It was held that it was always open to the state to tax certain class of goods and not to tax others and that the legislature was the best judge to decide as to the incidence of taxation and also as to the amount of tax to be levied in respect of different goods. It was observed" the Act recognises and gives effect to the well established principle that there must be a great deal of flexibility in the incidence of taxation of a particular kind. It must vary from time to time

66.A.I.R.(1962) S.C.97,102.
67.A.I.R.(1963) S.C.98.
68.The Court cited Art.43 of the Constitution of India which reads "The State Shall endeavour to secure... the State shall endeavour to promote cottage industries on an individual or co-operative basis in rural areas" to uphold the exempt - ion. See Ibid at 103 .

as also in respect of goods produced by different producers and agencies. The State naturally is interested in raising all the revenue necessary for public purposes without sacrificing the legitimate interest of persons and groups who deserve special treatment for reasons to be determined by the State".

In K.T.Moopil Nair v. Kerala,[69] S.7 of Travancore Cochin Land Tax Act,1955 empowered the State Government to grant exemptions partially or wholly from the provisions of the statute. The Supreme Court by a majority struck down the section as conferring uncanalised, unlimited and arbitrary power to the Government.[70] This decision could not be easily distinguished as in that case there was no evidence before the court that in fact any exemption was granted to anyone. Normally in such circumstances the courts would not answer the question as it has only an academic interest.[71]

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69. A.I.R.(1961) S.C.552.
70. Probably the absence of the term-"in the interests of general public" in the section was fatal. See Rao Manohar Singh v.Rajasthan, A.I.R.(1954) Raj.85. S.71(2) of Rajasthan Excise Act,1950 was struck down but remedy was refused to the petitioner, as the exemption in favour of petitioner was given under a similar invalid section and cancellation was held not illegal.
71. cf. New Central Jute Mills Co. v.Asst.Collector of Excise, A.I.R.(1971) S.C.454, 456, where S.12 of Central Excise & Salt Act which empowered Central Government to apply any provision of Customs Act, with alterations was challenged as being unconstitutional. But the court refused to answer as no changes had been made; Ram Bachan Lal v. Bihar,A.I.R.(1967) S.C.1404, 1407. See also Seervai, H.M. Constitutional Law of India op.cit.,p.250.

Lastly the question remains whether the legislature could validly delegate the power to fix the rate of tax to another body. The answer to this question would depend on the issue whether such power is an essential legislative function and whether the safeguards provided are sufficient.[72] In Jagannath Baksh Singh v. Uttar Pradesh[73], the U.P.Large Land Holdings Tax Act,1957 provided for fixation of annual value for the purpose of taxation at 12 1/2 multiple of rent payable or by a lesser one prescribed. As the maximum rate was prescribed the power to adjust the rate within the maximum to local conditions was upheld by the Court. The view that the power to fix rate could be validly delegated by a legislature if the maximum rate was fixed by the legislature itself was reiterated

72. See Sarkar, J., in Corpn., of Calcutta v. Liberty Cinema, A.I.R.(1965) S.C.1107,1118.

73. A.I.R.(1962) S.1563. The rules framed also had to be laid before the legislature. See Oudh Sugar Mills v.Uttar Pradesh,A.I.R.(1960) All.136,150(F.B.).

in Ram Bachan Lal v. Bihar.[74] But in Corpn. of Calcutta. v. Liberty Cinema.[75] Sarkar, J., for the majority observed that they were unable to see how the specification of the maximum rate supplied any guidance as to how the amount of tax which no doubt had to be below the maximum, was to be fixed. It was held that provisions for such maximum, only set out a limit of the rate to be imposed and a limit was only a limit and not a guidance. This statement, it is submitted, could only mean that apart from specification of a maximum rate, the legislature should also give other guidelines in order to make the delegation of power to fix the rate of tax to be valid.

The cases that have arisen in this area could be classified conveniently into those which deal with delegation

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74. A.I.R.(1967) S.C.1404,1407, See also K.S.Ingale v. Bhusawal Borough Municipality, A.I.R.(1966) Bom.15,18(held that though the Act did not fix the maximum in regard to profession tax it was fixed by Art.276); Bhikam Chand v. Rajasthan, A.I.R.(1966) Raj.142,152; Dhannalal v.Rajasthan, A.I.R.(1964) 106,109; A.K.Mukherjee v. Local Board,Barpeta, A.I.R.(1959) Ass.221,229.
75. A.I.R.(1965) S.C.1107,1118. But recently in Sita Ram Bishmber Dayal v. Uttar Pradesh,A.I.R.(1972) S.C.1168,1170 Hegde, J., held that where the legislature had fixed a reasonable upper limit the delegation of power to fix rate of tax valid. Mathew, J., in V.Nagappa v.Iron Ore Mines Cess Commr., A.I.R.(1973) S.C.1374,1379 held that the fixation of maximum rate would indicate that the delegate was not given an uncontrolled discretion in the matter of fixing the rate. In D.Ramaraju v.Andhra Pradesh,A.I.R.(1972) S.C.828,839-840 a curious argument that the legislature should provide the minimum rate also was turned down as one without substance.

to the executive government and that to the local authorities. First we take up here the cases which deal with delegation of power to fix rate of tax to the executive government.

The leading case on this point is Banarasidas Bhanot v. Madhya Pradesh,[76] where Venkatarama Aiyar, J. observed "Now the authorities are clear that it is not unconstitutional for the legislature to leave it to the executive to determine details relating to the working of taxation laws, such as the selection of person on whom the tax is to be laid, the rates at which it is to be charged in respect of different classes of goods, and the like". There the matter, as discussed above, was not in issue as the Court was concerned only with the power of the Government to cancel an exemption given by the legislature itself. In Devidas v. Punjab,[77] Section 5 of Punjab General Sales Tax Act,1949 which provided" subject to the provisions of this Act,there shall be levied on the taxable turnover, every year of a dealer a tax at such rates as the Provincial Government may by notification direct" was challenged as being unconstitutional for excessive delegation.

76. A.I.R.(1958) S.C.909,913 discussed supra.The Madhya Pradesh Sales Tax Act,1958,S.11 provided for laying of such notifications before the State Legislature.See also S.58(2) of Kerala General Sales Tax Act,1963 for such a requirement.

77. A.I.R.(1967) S.C.1895.See also Punjab v.Sansari Mal,A.I.R.(1968) S.C.331. Ganga Ram v.Punjab(1963) 14 S.T.C.476; Nabha Rice & Oil Mills v.Punjab,A.I.R.(1963) Punj.549.

Subba Rao, C.J., speaking for the Court[78] held that where the power to fix rates had been delegated by the legislature ample guidance should be provided in that regard. The argument that constitutional and statutory needs would afford reasonable guidelines for the Government to fix rates was rejected and it was held[79] that the general constitutional power to impose tax had no relevance in discovering a statutory policy under a particular Act. The Court struck down S.5 of the Sales Tax Act as conferring uncontrolled power to fix rates.[80] Two earlier decisions handed over by the Kerala High Court also show that in such cases the courts take a stricter view. In Standard Motor Union v. Kerala,[81] S.12 of T.C.Motor Vehicles Taxation Act,1950 which authorised the levy of tolls at such rates fixed by the Government for the use of any road or bridge when the Government was satisfied that special circumstances existed was challenged for excessive delegation of essential legislative

78. The bench consisted of Subba Rao,C.J., Shah,Shelat, Bhargava and Mitter, JJ.,
79. A.I.R.(1970) S.C.1895,1900.
80. Ibid at 1901. However this infirmity was held to be cured by the Amendment Act of 1958 which limited the power to fix rate between 1 and 2 paise.
81. A.I.R.(1962) Ker.298(Vaidyalingam, J.)

power . Upholding the contention it was held that the[82] Legislature had failed to specify as on what basis the toll had to be levied. In the other decision Damodaran v. Kerala,[83] S.18 of T.C.Motor Vehicles Taxation Act,1950 which empowered the Government to amend, alter, add or cancel any part of the schedule which fixed the maximum rate of tax was impugned as violative of the rules as to permissive delegation. It was held that the fixation of rate of tax being an important feature, the provisions were bad as it did not lay down any principle for the guidance of the executive.

In Gwalior Rayon Mills v. Asst. Commr. Sales Tax,[84] Section 8(2) (b) of the Central Sales Tax Act,1956 was challenged on the ground that a sale of non declared goods in the course of inter state trade or commerce made to a non registered dealer was taxable at the rate of 10% or the rate prevailing in the appropriate state whichever was higher. The contention

82. Ibid at 300. The learned judge observed that the sweeping dicta by Venkatarama Aiyar, J., in Banarsidas case A.I.R. (1958)S.C.909 should be understood in the light of the observation that amendment of the schedule did not "in anyway alter the essential feature of the law, nor does it involve any change of policy as enunciated in the Act" Ibid at 307.

83. A.I.R.(1960) Ker.58,62. Banarasi Das case was distinguished as obiter. But being a decision by the Supreme Court such a view seems incorrect on the doctrine of precedent.

84. A.I.R.(1974) S.C.1660.

was that the Parliament had simply adopted the rate applicable to sale or purchase of goods inside the appropriate state in case such rate exceeded 10 percent and thus had abdicated its legislative function. Rejecting the contention, it was held[85] that the object of the provision was to prevent evasion of tax in cases of sales effected to unregistered dealers. It was also held that a definite legislative policy could be discerned, the policy being that the rate of central sales tax should in no event be less than the local rate of sales tax.[86]

The principle is clear that where the rate of tax is not an essential feature, such power could be validly delegated without laying down any rule for the guidance or policy. In <u>Manikant Lakamsey Namda</u> v. <u>Mysore</u>,[87] the Bombay Land Revenue Code was challenged for delegating the power to fix rates. Rejecting the contention it was held that fixation of rate of land revenue depended on so many uncertain conditions.[88] Recently in <u>Sita Ram Bishamber Dayal</u> v. <u>Uttar</u>

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85. Ibid at 1663.(Khanna, J.) Mathew, J.,(concurring) observed "Parliament thought that unless the rate fixed by the States from time to time is adopted as the rate of tax for inter-State sales of the kind specified in the sub-clause, there will be evasion of tax in inter-State sales as well as discrimination" Ibid at 1681-1682.
86. Followed in <u>International Cotton Corpn</u>. v. <u>Commercial Tax Officer, Hubli</u>, A.I.R. (1975) S.C.1604,1607-1608
87. A.I.R.(1966) Mys.278,287; in <u>Rajashekar</u> v. <u>Mysore</u>, A.I.R. (1966) Mys.304,309, it was held that the rate of tax was not an essential legislative function in the matter of fixing land revenue probably on the view that land revenue used to be levied formerly without legislative sanction.
88. The legal position was that land revenue could be imposed by executive fiat. Hence strictly speaking no question of delegation arises.

Pradesh,[89] Hegde, J., observed that though tax was levied primarily for the purpose of gathering revenue, in selecting the objects to be taxed and in determining the rate of tax, various economic and social aspects such as the availability of goods, administrative convenience, the extent of evasion, the impact of tax levied on the various sectors of the society etc., had to be considered. In a modern society his lordship observed, taxation was an instrument of a planning which could be used to achieve the economic and social goals of the state and for which reason the power to tax must be a flexible one.[90] But in this case theupper limit of the rate of tax was fixed by the legislature itself.

Regarding the delegation of power to fix the rate of tax to authorities of local self government, the courts have adopted a less stringent view. This is understandable as the delegation is to a body of elected representatives of the people, which body knows more about the financial capacity[91]

89. A.I.R.(1972) S.C.1168,1169. The validity of S.3D(1) of U.P.Sales Tax Act,which empowered the State Government to levy purchase tax at a rate not exceeding 2 paise in case of food grains and 5 paise in other cases, was upheld by the Court.
90. If such rate was to be fixed after consultation with affected interests such a provision would be one containing reasonable guideline. For example, see a case from Australia, Commonwealth v. Morton,(1968) 117 C.L.R.383, 388. Where the Poultry Industry Levy Act,1965 authorised the Governor General to fix the rate of levy after considering any recommendation made by council of egg marketing authorities of Australia.Even though the council had no corporate existence or statutory basis,the provision was held to be valid.
91. See Gauri Shankar v. Muni.Board,A.I.R.(1958)Raj.192,196.

of the inhabitants to pay the tax. In such a case the only danger seems to be of local preferences and discriminations and the checks provided by the elaborate procedure of taxation including an opportunity to affected persons to file objections and to support them at an hearing which is much more a safeguard than mere consultation of affected interests and the provision for approval or sanction by the state government would certainly minimise the possibility of such preference or discrimination.

The leading case on this point is Corporation of Calcutta v. Liberty Cinema,[92] where the validity of S.548(2) of the Calcutta Municipal Act,1951 which authorised the appellant Corporation to levy licence fees" at such rate as may from time to time be fixed by the Corporation" was in issue.The majority[93] held the levy to be a tax in its true content though termed a licence fee in the statute. On the question of validity of the delegation of the power to fix the rate of the levy, the majority held that such power could be validly delegated if the legislature provided guidance for fixation of rate. It is submitted that though the majority approved the observation made by Venkatarama Aiyer, J., in Banarsidas

92. A.I.R.(1965) S.C.1107. The bench consisted of Sarkar, Subba Rao, Raghubar Dayal,Rajagopala Ayyangar and Mudholkar, JJ. The majority judgement was delivered by Sarkar, J., for himself, and Raghubar Dayal and Mudholkar JJ., Subba Rao and Ayyangar, JJ., dissented.

93. Ibid at 1116. The minority held the levy to be only a fee, see Ibid at 1133(Ayyangar,J.).The Calcutta High Court in an earlier case Corpn. of Calcutta v.Sarat Chandra Ghatak,A.I.R.(1959) Cal.704,706 had taken the view that the levy though termed a license fee was in fact a tax.

Bhanot Case,[94] in effect much of the basis and content of it was watered down. That is to say, if the majority had approved the dicta in Banarsi das Bhanot case, it ought to have held that the fixation of rate of tax was an administrative detail.[95] If that was the case no question of further enquiry regarding guidance arose because the law was that proper guidance should be provided only where an essential feature of legislation was delegated. Hence it is submitted that dicta in Banarsi das Bhanot case no longer helds good.

As to the sufficiency of guidance in the Liberty Cinema case[96] it was held that the needs of the taxing body for carrying out its functions under the statute for which alone the taxing power was conferred on it could afford sufficient guidance in such cases. The guidance furnished was held to be good if it led to the achievement of the object of the parent statute. All taxes levied and collected by the Corporation could be used only for discharging the functions entrusted to it under the statute. The money required for discharging these statutory functions might vary from time to time with the prevailing exigencies and it was held that it could fix such rates as may be necessary to meet the needs.

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94. A.I.R.(1958) S.C.909.913.
95. See.However Hidayathullah, J., inDelhi Municipality v. Birla Cotton Spg.& Wvg.Mills, A.I.R.(1968) S.C.1236,1252 observed that in Liberty Cinema case the majority considered the rate of tax as not an essential part of legislative function.
96. See A.I.R.(1965) S.C.1107,1118. Followed inRam Bachan v. Bihar,A.I.R.(1967)S.C.1404,1407; V.Nagappa v.Iron Ores Mines Cess Commr., A.I.R.(1973) S.C.1374,1379; Wanchoo,C.J. in Delhi Municipality v.Birla Cotton Spg.& Wvg.Mills, A.I.R.(1968) S.C.1232,1245-1246.

It is true that the legislature is not fully aware of the fact as to which tax could be levied with maximum advantage and minimum hardship. The best person to decide as to a tax on what activity or goods would bring sufficient proceeds for the discharge of its statutory obligations and which would not at the same time be not oppressive to the tax payer, is the corporation itself, which knows who are rich and who are poor in the locality.[97] The only objection to the above decision is about the majority observation that "Its power to collect tax, however, is necessarily limited by the expenses required to discharge these functions". It is difficult to understand how an estimate of expenses could be a fetter on the power to tax. Does it mean that a court of law would interfere only where the corporation collects more money than it find ways to spend? It is submitted that in such cases the only check could be that by the state government in the form of sanction to taxes levied by local authorities. In effect validity of S.548 of Calcutta Municipal Act was upheld.

97. In the present case the former tax on cinema house was Rs.400/- per year.It was raised to Rs.5/- per show and the respondent cinema was liable to pay Rs.6000/- per year. The respondent cinema house had a capacity of 551 seats and this was held not to be ureasonably high. At page 1120 of the Report a contention that any law made under entry 5 of list II to the Seventh Schedule in which a taxing power was conferred could be exercised only for the purpose of the Corporation and as such no question of guidance really arose, was left open though their lordships observed that they thought the contention deserved consideration.

Rajagopala Ayyangar, J., speaking for the minority examined the question whether the Legislature had provided any guidance to the Corporation in the matter of fixing the rates of tax. Regarding the contention that the amount of money which a ~~taxx~~ municipality needs for discharging its statutory functions was itself a sufficient guidance[98] his lordship observed that a skelton legislation such as an income tax Act containing a "single section empowering the executive to levy the tax at such rates as they might consider appropriate on the different classes of persons who they consider proper and with reference to such income as they might choose to tax"[99] would be valid as the money needed by the Union Government for the activities which it might undertake should be a valid guidance. The contention was held to be unsupportable in law and the provision was held to be unconstitutional. The majority judges did not even consider the supervisory powers conferred on the State Government as

98. See A.I.R.(1965) S.C.1107,1141.

99. Ibid at 1139. See Hidayathullah, J., in Delhi Municipality v. Birla Cotton Spg. & Wvg.Mills, A.I.R.(1968) S.C.1232, 1255. "We do not agree that our view will make it easy for the legislatures to name a tax and leave it to be imposed by the Executive at its sweet will".

sufficient to make the provision valid.[100]

The next case Delhi Municipality v. Birla Cotton Spg. & Wvg.Mills,[101] was concerned with the constitutional validity of S.150 of Delhi Municipal Corporation Act,1957. The Act empowered the Corporation to levy two types of taxes namely obligatory taxes (by S.113 (1))and optional taxes (by S.113(2)). In the case of obligatory taxes the Legislature had provided the maximum rate of tax except for water, scavenging and fire taxes. In the case of optional taxes the maximum rate had to be fixed by the Corporation by a resolution and had tobe approved by the Central Government under S.150(1) and (2). The Corporation could levy the tax fixing the actual rate after following a prescribed procedure. Wanchoo, C.J.,[102] after reviewing the previous decisions observed that the nature of the body to which delegation was made was also a factor to be taken into consideration in deter - mining whether there was sufficient guidance in the matter of

100. A later attempt to subvert such plenary supervisory control over local authority taxation was attempted without success in Hapur Municipality v.Raghuvendra Kripal, A.I.R. (1966) S.C.693,698. The Court held that the State Government was the final authority regarding validity of a tax imposed except where there was a fundamental defect in the imposition of tax.
101. A.I.R.(1968) S.C.1232. The Bench consisted of seven judges and four judgments were delivered. One by Wanchoo, C.J., for himself and Shelat, J., second by Hidayathullah, J., for himself and Ramaswami, J., the third byShah, J., for himself and Vaidyalingam J., expressing a dissenting view and lastly by Sikri, J.
102. ~~Ibid~~ A.I.R.(1968) S.C.1232,1244.

delegation. It was held that the guidance might take the form of maximum rates of tax, consultation with the people of the local area and fixation of rate of tax after such consultation and provision for approval of sanction by government which acts as a watch dog. According to his lordship the legislature while delegating a legislative power to another body, in order to make such delegation valid should ensure that such power would be exercised reasonably. Enumerating those safeguards in the present case as (1) delegation was to a body of elected representatives of the people taxed[103] (2) financial needs of the authority in discharge of its statutory obligations was a guidance,[104] (3) rates fixed by the statute itself in respect of obligatory taxes provided a guidance,[105] (4) provision for sanction by Central Government and (5) that court could interfere if the rate of tax fixed

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103. Ibid at 1245. What would happen if such representative bodies were superseded by the State Government was left open.
104. Ibid following Corporation of Calcutta v. Liberty Cinema, A.I.R.(1965) S.C.1107,1118.
105. A.I.R.(1968) S.C.1236,1246.

was unreasonable.[106] Wanchoo, C.J., upheld the validity of S.150. Hidayathullah, J., in a separate concurring judgement brushed aside the whole question of delegation by observing[107] that once it was established that the legislature itself had willed that a particular thing be done and had merely left the exercise of it to a chosen instrumentality(provided that it had not parted with its control) there could be no question of excessive delegation. If that be the law, no question of excessive delegation can arise even if what the legislature does is to enact what is called a skeleton legislation, that is to say, simply that a named tax shall be levied and collected by such and such authority, because even in such a case the 'legislative control' is not parted with as at any time the legislature can undo or even withdraw such power. Probably that was why his lordship held that the tax levied could be challenged as unreasonable.[108] As an illustration as to how a

106. Ibid at 1247 relying the decision in Kruse v. Johnson, (1898) 2 Q.B.91,99-100. That decision was concerned with byelaws framed by local authorities. It is surprising to see that other judges who took a very lenient view of delegation also expressed similar opinion. See Hidayatullah, J., at 1254 and Sikri,J., at 1266. It is even doubtful whether the Delhi Municipal Corpn.case is an independant authority for the view that a tax can be invalidated for unreasonableness. Even if the principle, that an unjust law must yield to justice apart from constitutional limitations is accepted, in laws imposing taxes regarded as ~~xxxxx~~ unduly high, the element of an unjust affront to the supreme value of life is absent. See Edgar Bodenheimer, Jurisprudence The Philosophy And Method of The Law (Harward,1970),p.303.

107. See A.I.R.(1968)S.C.1232,1253.

108. Ibid at 1254.

tax might become unreasonable his lordship ~~as~~ pointed out that power to tax is conferred for certain purposes and the inter relation of taxes with expenditure had to be maintained and added" this relation must be reasonable". But how reasonable? The cases cited to illustrate the point are all cases relating to fees where it had been held that a fee should have relation with services rendered. The other case cited namely, A.G. of Alberta v.A.G. of Canada,[109] related to an exorbitant tax which was in effect prohibitive of banking business. But in India the settled legal position is that a tax might not be challenged for harshness or excessiveness but only as expropriatory or as a colourable exercise of power.[110]

Sikri, J.,[111] the other judge who concurred held that the "purpose" mentioned in S.113 of the statute was sufficient guidance as tax could be levied only for the purpose of achieving those objectives or results.

Shah and Vaidyalingam, JJ., dissented. Shah, J.,[112] speaking for the minority pointed out that the present case was

109. A.I.R.(1939) P.C.53,57 -58.
110. See Hari Krishna v.Union of India,A.I.R.(1966) S.C.619, 623; Jagannath Baksh Singh v.Uttar Pradesh,A.I.R.(1962) S.C.1563, 1572.
111. A.I.R.(1968) S.C.1232,1266. Sikri,J., in his separate opinion observed that the only question regarding delegation is whether the legislature had abdicated its function as Indian legislatures having plenary powers had full power to delegate also.
112. Ibid at 1263.

different from the facts in _Corpn. of Calcutta_ v. _Liberty Cinema_,[113] as in that case the Corporation was authorised only to fix the rate of tax. In the present case it was pointed out that the statute authorised the Corporation apart from fixing the rate of tax also to select persons to be rendered liable to tax, system of assessment to be adopted and to provide for exemption to be granted if any, Thus it was wholesale delegation of the plenary power to tax to a subordinate body.[114] It was held that if the needs of a local body be an indication of guidance in such cases, the rule against excessive delegation of legislative authority would be reduced to a vanishing point.[115] It was also held that safeguards against abuse was not a substitute for guidance and that rule against delegation was not inapplicable because the delegate is a high dignitary of state, or is especially versed in a particular branch of administration or has special information or is not likely to abuse its authority.[116]

113. A.I.R.(1965) S.C.1107.
114. A.I.R.(1968) S.C.1232,1263; cf._Sethumadhavan_ v. _Visakhapatnam Municipality_, A.I.R.(1964) A.P.280,where power to fix rate for water supplied on such basis, at such times and on such conditions as might be laid down under the provisions of S.32 of Madras Dist.Municipalities Act,1920 was upheld.
115. Ibid at 1265.
116. Ibid at 1262.

It is submitted that the decision by the learned Chief Justice is a path clearing one as one discarding the old tendency to search for an undisclosed policy in the provisions of the statute itself. On a practical consideration the basic idea of the rule against excessive delegation is that the safeguards which are available in a legislation by the legislature against arbitrariness or abuse are necessarily absent when such power is delegated and hence for the ptorection of the people the legislature should ensure[117] that such powers are properly exercised. Enunciation of policy or guidelines is only one of the modes by which a legislature can ensure that the delegate would not transgress such powers conferred and providing safeguards such as consultation of affected interests, supervision of such exercise of power etc., are other modes and quite legal. The realisation and approval of this fact is the crux of this decision.

Recently in Gulabchand Bapalal Modi v. Ahmedabad Municipality,[118] validity of S.129 of Bombay Provincial Municipal Corporation Act,1949 which provided that a property tax at a

117. " A positive approach to the dangers of delegation is to develop the many devices for safeguarding and improving its operation". Louis L.Jaffe " An Essay on Delegation of Legislative Power II" (1947) 47 Col.L.Rev.561,593.
118. A.I.R.(1971) S.C.2100(Shelat and Vaidhyalingam,JJ).

rate not less than 12½ of the rateable value of buildings and lands shall be levied by the Corporation was challenged on the ground that no maximum rate of tax was provided by the statute.[119] Rejecting the contention it was held that the mere fact that an Act delegating taxing power refrained from providing a maximum rate did not by itself render the delegation invalid. It was pointed out that the Corporation could levy tax only for the purposes mentioned in the statute, that the ultimate control both for raising the taxes and incurring expenditure lay with the councillors chosen by and responsible to the people and that the State Government should sanction the proposals by Corporation to tax[120] and it was held that the power to levy the property tax was not so unbridled as to make it possible for the Corporation to levy it in an arbitrary manner or extent.

From the foregoing study it is clear that in the case of executive government the courts apply the tests of valid delegation more strictly than that in the case of local self government.

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119. Ibid at 2107. In Anant Mills v. Gujarat, A.I.R.(1975) S.C. 1234,1248 the same provision for the levy of conservancy tax was upheld as the rate was to be fixed with a view to covering the expenses for conservancy services. The entire procedure was held to provide built-in-safeguards and lay down adequate guidelines in the matter of taxation.

120. Ibid at 2105.

The third and last feature of a taxing statute is the provisions for collection and recovery of tax and provision to check the evasion of tax. Generally speaking, the legislature itself provides the modes of collection and recovery of the tax such as payment of advance tax, imposition of penalty, attachment and sale of property of the assessee, 'garnishee' proceedings against debtors of the assesses and for proceeding against the person of the assessee. It is doubtful whether the executive government could be left with the power to evolve its own method to collect the tax. It has been held that where the legislature has laid down different procedures for recovery of tax, the authority might be left with the discretion to select, any one or more suitable procedure.[121] In <u>Collector of Customs Cochin</u> v. <u>A.S.Bava</u>,[122] the validity of S.12 of Central Excise and Salt Act,1944 which empowered the Central Government to apply any of the provisions of Customs Act,1878 relating to offences and appeal, power to search the premises and for seizure of any document was upheld. In <u>New Central Jute Mills</u> v. <u>Asst.Collector.Central Excise</u>,[123] it was held that though that section provided for such

121. See <u>M.A.Rahman</u> v. <u>Andhra Pradesh</u>, A.I.R.(1961) S.C.1471,1473.
122. A.I.R.(1969) S.C.13. Extension of S.129 of Customs Act,1962 which provided for the deposit of duty or penalty before filing an appeal was struck down on the ground that that affected the substantive right of appeal provided by S.35 of the Act.
123. A.I.R.(1971) S.C.454,456.

modifications and alterations as it might consider necessary or desirable the term"alteration" should be understood in a sense e in which it was open to the legislature to employ it legitimately and in a constitutional manner.[124] It has been held that power to prescribe periods of limitation for initiation of proceedings is to be expressly delegated for and could not be implied from a general power to prescribe procedure.[125]

Lastly come the provisions to check evasion of tax. In two leading decisions on this point M.M.Ipoch v. C.I.T. Madras,[126] and in J.R.G.Mfg.Assn. v. Union of India,[127] the delegation of discretionary power to assess, in the first case, under Income Tax Act either as individuals or as an association of persons and in the second case under the Rubber Act to assess either the rubber manufactures or rubber producers was held to be properly guided by considerations of checking

124. See Bajranglal & Nandlal v. Commr. of Taxes, A.I.R.(1959) Ass.216. It was held that the power delegated to provide for fee for filling appeal was valid.
125. Bharat Barrel & Drum Mfg.Co. v. E.S.I.Corpn., A.I.R.(1972) S.C.1925
126. A.I.R.(1968) S.C.317 discussed supra.
127. A.I.R.(1970) S.C.1589 discussed supra.

the evasion of tax. In Kotkapura Bus Service v.E.& T.O. Jullunder,[128] S.6(4) of Punjab Passengers and Goods(Taxation) Act,1952 which conferred power on the assessing authority to reopen assessments of previous years was challenged as conferring arbitrary power as no time limit beyond which the officer could not reopen past assessments was laid down. It was held that the assessment after reopening a case was to be made under the provisions of the Act and that the provision was enacted to check evasion and fraud on revenue and thus the provision was upheld valid.

128. A.I.R.(1964) Punj.438,442.

CHAPTER IV.

CERTAIN ASPECTS OF THE EXERCISE OF THE POWER OF TAXATION BY AUTONOMOUS BODIES

The power of taxation is often delegated to self governing institutions and autonomic bodies by the legislature. Taxation by municipal and local authorities is an example of such taxation. These authorities are held under modern theory not to have any sovereign inherent power to levy tax. But as the state government so these local self governing bodies have to defray the cost of municipal functions. In this regard even a constitutional provision such as Art.276, which puts a ceiling on the maximum amount of tax on profession leviable by local authorities, is not considered to be self executory, and these authorities require express legislative sanction to impose the tax.[1] The legislatures can authorise these bodies so levy only those taxes, which they themselves are competent to levy under the Constitution.[2] Being a statutory grant, the power of taxation exercised by the local authorities are strictly construed by courts of law.[3]

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1. Under Art.265 legislation is necessary to levy or collect a tax.
2. Ram Krishna v. Janapad Sabha, A.I.R.(1962) S.C.1073, 1080.
3. Where the statute provided that the local authority could impose tax after obtaining the previous sanction was a condition precedent for valid taxation See Jeo Raj v. Rajasthan, A.I.R.(1960) Raj.73; Jiwanlal v. Rajasthan, A.I.R.(1960) Raj.86; Jethmal v. Rajasthan, A.I.R.(1960) Raj.73.

The limitations on the taxing power of local authorities may be either general implied limitations on the taxing power or those express limitations imposed by the constitution, parent statute, and by contract.[4]

Regarding the first type of limitation the local authority has no power to impose a tax for a private purpose or for a purpose which is alien to its corporate purpose defined in the parent statute or to impose a tax on property or person situated outside the territorial jurisdiction of such local authority.

Regarding the second type of limitations, such restrictions may flow from the parent statute itself. This is taken up first for discussion. The restrictions which flow from the Constitution may be general or specific in nature. The general restrictions fall under fundamental rights, freedom of inter state trade and commerce etc., and are discussed separately. The specific constitutional restrictions under Art.276 is dealt with in the chapter dealing with tax on profession and trades.

Since the local authorities have no inherent power of taxation it is only natural that the courts should insist compliance of the statutory requirements imposed by the constituent statute. Apart from such statutory requirements, there are no general principles requiring such procedure to be followed before taxes are levied by local authorities.[5] It has

4. See Century Spg.& Mfg.Co., v. Ulhasnagar Municipal Council, A.I.R.(1971) S.C.1021, a promise not to levy octroi was enforced as an estoppel.
5. M.P.Sugar Mills v.Kanpur Municipality,A.I.R.(1969)All.393,395.

It has been held that a mere inclusion of a new territorial area in a local authority would not ipso facto extend a taxes already in force into that area.[6]

It is a usual phenomenon to lay down a procedure for imposition of rates or local tax by the Municipality or local authority. This is done because the state legislatures only empower the local authorities to levy particular taxes. When these local authorities impose the tax, provisions are made to give the inhabitants an opportunity to propose objections and variations. In Hapur Municipality v. Raghuvendra,[7] Wanchoo, J., observed that those provisions indicated the safeguards the legislature intended in a case of that kind when the legislature itself had not indicated the rate of tax

6. Atlas Cycle Co. v. Haryana, A.I.R.(1972) S.C.121; Visakhapatnam Municipality v. K.Nukaraju A.I.R.(1975)S.C.2172,2177.

7. A.I.R.(1966) S.C.693,701. In Parekh & Bros. v. Mysore, A.I.R. (1969) Mys.167 it was held that if the local authority wanted to impose octroi duty on additional goods, the same procedure for a fresh levy should be followed. The decision is based on the theory that the public should have an opportunity to object to the levy on particular goods. But such safeguard is not available when a resolution was defective as it did not mention the octroi limits and that was rectified later, see Tulsipur Sugar Co. v. N.A. Committee, A.I.R.(1968) All.285,288.

but had merely indicated the heads of taxation and the fixation of rate of tax and all indidental matters had been delegated to the board subject to the supervision of the state government. Such procedure has to be strictly complied with for the valid imposition of a tax and where it is not so complied with the liability to pay the tax cannot be said to be by "authority of law" under Art.265.[8]

Under the U.P.District Boards Act,1922 a board had to pass a special resolution under S.119 fixing a date on which the proposed tax or rate would come into operation when sanctioned by the State Government ~~as~~ in Zila Parishad,Moradabad v. Kundan Sugar Mills,[9] no such resolution was passed and the court held that if no date was fixed, no tax could be imposed. In Khurai Municipality v. Kamal Kumar,[10] the revised valuation list preparted was suspended by the District Collector owing to certain allegations of partisan attitude of the sub-committee

8. See Mudholkar, J. in Khurai Municipality v.Kamal Kumar, A.I.R.(1965)S.C.1321,1325. Even prior to the Constitution the law remained the same. See C.B.Bates v. The Municipal Commissioner,Bellary,(1873) VII Mad.H.C.249; G.D.Leman v. Damodarayya,(1876) I.L.R.1. Mad.159,162(Holloway and Innes, JJ.) These decisions were concerned with demand of tax for a period prior to which the tax was legally due; Kamayya v. Leman(1878) I.L.R.2 Mad.87; Municipality of Poona v. Lilachand,(1884) I.L.R.Bom.51; T.E.Strachey v.Municipal Board of Cawnpore,(1899) I.L.R.21 All.349(the objections to the imposition of tax were not considered and the levy was declared illegal).

9. A.I.R.(1968) S.C.98,100;Sukaiah v.Town Panchayat,Kottur, A.I.R.(1967) Mys.150,153.

10.A.I.R.(1965) S.C.1321. It was also held that delegation of power to hear and decide objections to the sub-committee was not authorised by the statute.Ibid at 1325.

which heard and decided the objections. But later the appellant attempted to revise the list without following the prescribed procedure and that was held to be not permitted by law. But a tax is not invalidated by the reason that the assessor who made the assessment was invalidly appointed[11] or because the notice of the meeting of the Corporation did not specify the object of the meeting, or purpose of tax to be imposed or the mode of valuation.[12] Though absence of notice to some of the members of the body might invalidate the meeting and the proceedings,[13] such a defect is curable by appropriate action.

If such provisions are directory in nature, substantive compliance is sufficient to make the tax valid. In Pioneer Motors Ltd. v. Nagercoil Municipal Council,[14] s.78 of the Travancore District Municipalities Act provided that a notice imposing a tax when published in the gazette should give a reasonable period of not less than one month for submission of objections by the inhabitants of the locality. The notice in the present case gave time "within thirty days",

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11. See Chairman of Chittagong Municipality v. Jogesh Chandra Rai, (1910) I.L.R. 37 Cal.44 (The assessment was confirmed by the Committee of Commissioners on appeal).
12. Parsons, J., in Surat Municipality v. Ochhavaram Jamandas, (1896) I.L.R.21 Bom.630,642-643.
13. cf. Joshi Kalidas v. Dakor Town Municipality, (1883), I.L.R. 7.Bom.399; Municipality of Sholapur v. Sholapur Spg. & Wvg. Co., (1895) I.L.R.20 Bom.732.
14. A.I.R.(1967) S.C.684.

that is to say, the first day and the last day of the month were not excluded. The Court held the provision to be procedural in nature, the object being to inform the rate payers[15] and hence directory in nature. In Vallabhadas v. Municipal Committee, Akola[16], it was held that the provision regarding publication of draft of "system of assessment" did not mean rules for assessment and collection but only a public notice of the intention to impose the tax.

In Raza Buland Sugar Co v. Rampur Municipality[17], the Supreme Court of India considered the effect of a provision which stated that a notification imposing a tax would be conclusive proof that the tax was imposed in accordance with the provisions of the statute. Here under the Uttar Pradesh Municipalities Act, 1916 the proposals of taxation had to be published in a local hindi newspaper. Such proposal was in

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15. The judgement pointed out that in fact nobody had objected. Ibid at 685.

16. A. I.R.(1967) S.C.133,135.

17. A.I.R.(1965) S.C.895. In an earlier case Berar Swadeshi Vanaspati v. Municipal Committee, Shegaon, A.I.R.(1962) S.C.420, 422. The Court held that the effect of such a clause was that the tax could not be challenged on the ground that all necessary steps had not been taken.

fact published in an urdu newspaper as there was no local hindi paper.[18] The court by a majority held that the manner of publication provided in the statute was only directory and that there was substantial compliance. Discussing the effect of the conclusive evidence clause the majority left open[19] the question whether such a provision would protect a tax imposed by a local authority without complying with any or even all the mandatory provisions relating to imposition of a tax.[20] In a concurring judgment Hidayathulla, J., held that such a provision laid down a rule of evidence which precluded courts from making inquiries into the minutiae of the procedure with a view to declaring the imposition invalid. The same statutory provision again came up for consideration in Hapur Municipality v. Raghuvendra,[21] and the Court by a

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18. A.I.R.(1965) S.C.895,901. The majority of the Court consisted of Gajendragadkar, C.J., Wanchoo and Dayal, JJ. Hidayathulleh, J., agreed with this view at 905 and Mudkolkar, J., at 905; in Azimulla v. Suraj Kumar Singh, A.I.R.(1957) All.307,310, it was held that the passing of special resolution imposing the tax was the foundation of the authority to tax and in its absence there would be no conclusiveness in regard to the procedure(Gurtu,J.)
19. Ibid at 903. Mudkolkar, J., also left open the matter, see Ibid at 905-906.
20. Ibid at 905.
21. A.I.R.(1966) S.C.693,696.

majority pointed out that the tax was the levy itself and imposition of tax was the method by which the levy was imposed and collected.[22] It was held that there could not be any conclusive evidence clause regarding the former and with regard to imposition of tax a conclusive evidence clause would protect only non compliance with directory provisions. Would it mean that if the statute contains no conclusive evidence clause the court would e insist upon substantial compliance of directory provisions also? Here the provisions for publicity were held to be directory in nature and hence protected by the conclusive evidence clause. Wanchoo, J.,who dissented[23] held the statutory provision ultra vires the Constitution being in excess of the limits of permissible delegation as the safeguards provided for taxation by local government were nullified by the provision. The legislature

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22. Ibid at 697. This decision was also concerned with the manner of publication of the special resolution to impose tax. The appellant Municipality was of the view that local newspapers were of no suitable circulation and hence a copy of the resolution was affixed on the notice board of the municipal building and was proclaimed by beat of drums.

23. Ibid at 703. According to Wanchoo, J., a conclusive evidence clause would normally shut all inquiry by a court of law as to whether the procedure for imposing the tax has been followed. Ibid at 702. The Allahabad High Court had earlier struck down the Section 135as violating Art.14 of the Constitution in Raghuvendra Kripal v. Municipal Board, Hapur,A.I.R.(1959) All.192.

while delegating the power to tax to local governments provides for objection and hearing to the inhabitants affected by such taxation, in the interest of the substance and purity of democratic local government. But if a mere notification could circumvent all such essential formalities of democratic local government, the legislature will be taking away the rights which it had earlier bestowed upon the citizen and on this view the judgement of Wanchoo, J., seems to be based on the correct principles of law.

The view that such a conclusive evidence clause would protect only non compliance with directory provisions was reiterated in Zila Parishad, Moradabad v. Kundan Sugar Mills,[24] and Raichur Municipality v. B.A.Prasanna.[25] Recently in Sitapur Municipality v. Prayag Narain,[26] the Supreme Court

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24. A.I.R.(1968) S.C.98, 100 fixation of a date from which the proposed tax would be operative was held to be mandatory in nature; P.C.Maheshwari v. Zila Parishad, Muzaffarnagar, A.I.R(1971) S.C.1966,1703.

25. A.I.R.(1968) S.C.255 whether procedure for modification of a resolution was followed was held could not be investigated in view of the conclusive evidence clause.

26. A.I.R.(1970) S.C.58; Dharanagadhara Chemical Works v. Gujarat, A.I.R.(1973) S.C.1041,1044,(the tax was invalidated for not following the mandatory provisions).

held that where the defects were of a fundamental character the conclusive evidence clause would not cure them. It was also held that procedural defects could be considered as invalidating the imposition only if substantial prejudice was caused thereby to the inhabitants. In that case the rate of proposed water tax was modified by a special resolution after hearing objections and receiving the governmental sanction. The modifications effected in the original proposal and the subsequent special resolution were not published. The court held that those defects were not fundamental so as to invalidate the imposition itself. From the above discussion it seems that the defects, which could be termed fundamental in character, are absence of resolutions to be passed and non-compliance with the provisions for opportunity to file objections to the proposed tax and to hear them.

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PART TWO

TYPES OF TAXES.

CHAPTER V.

TYPES OF TAXES

FEES

The Constitution of India maintains a well defined and broad classification between general legislative powers and power of taxation in the legislative lists in the Seventh Schedule.[1] A tax could be imposed only under one of the entries dealing with taxation and not as an incidental power to the general legislative power.[2] Though the term[3] "taxation" generally includes "fee" also, the Constitution of India has kept them apart throughout its provisions. For example, the definition of money bill in Arts.110(2) and 199(2) excludes bills imposing fees. So also specific legislative power is conferred to levy fees under entries 96,66 and 47 of Union, State and Concurrent Lists of the

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1. In the Union List entries 82 to 92A deal with taxation and in the State List entries 45 to 63 deal with taxation, the residuary power of taxation lies with the Union Legislature under entry 97 of the Union List read with Art.248.

2. M.P.V. Sundararamier & Co. v. Andhra Pradesh, A.I.R.(1958) S.C.468,493-494 (Venkatarama Aiyar, J.)

3. Art.366(28) reads "taxation" includes the imposition of any tax or impost, whether general or local or special and "tax" shall be construed accordingly". According to Seligman, "The taxing power may manifest itself in three different forms, known respectively as special assessments, fees and taxes" Seligman, Essays In Taxation op.cit., p.406.

Seventh Schedule. A fee is leviable under all the entries in the three lists including an entry dealing with taxation.[4] The Supreme Court of India has also observed in Sri Jagannath Ramanuj Das v. Orissa,[5] " As has been pointed out in Madras appeal, there is no generic difference between a tax and a fee and both are different forms in which the taxing power of a State manifests itself". As "tax" in the narrow sense and "fee" are species of "taxation" in the wider sense, we have to see the distinguishing features of a fee.

The term fee has been no where defined in the Constitution. The courts have endeavoured to define the term in contra distinction to the term 'tax'. In Commissioner H.R. E. v. L.T.Swamiar,[6] Section 76 of Madras Hindu Religious Endowment Act,1927 which provided for a contribution at the rate of 5% of the income of a religious institution and an

4. For example, provision for registration fee and fee for filing appeal from assessment orders in sales tax laws. See Rajagopala Ayyangar, J., in Calcutta Corpn. v. Liberty Cinema, A.I.R.(1965) S.C.1107,1123; Orissa v. Chakobhai Shela bhai & Co., A.I.R.(1961) S.C.284,287.

5. A.I.R.(1954) S.C.400,403.

6. A.I.R.(1954) S.C.282.

additional levy of 1½% where such income exceed Rs.1000/- to meet the cost of services and auditing was challenged as imposing not a fee but a tax in reality. Mukherjea, J., speaking for the Court adopted the definition of tax by Latham, C.J.,[7] namely " a tax is a compulsory exaction of money by a public authority for public purposes, enforceable by law and not a payment for services rendered". Taxes are paid for the participation in such common benefits such as organised society and a person cannot object to a tax on the ground that he receives no direct benefit from the application of the proceeds of the tax or that the benefit he receives is small in comparison with the benefits received by other tax payers.[8]

Regarding the first element, compulsion, the

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7. In Matthews v. Chicory Marketing Board, (1938) 60 C.L.R. 263,276. The learned Chief Justice had made this definition in his dissenting opinion in the above case. The definition was applied by the Australian High Court in Brown's Transport Pty.Ltd. v.Kropp, (1958) 100 C.L.R. 117,129. In Australia charges for a services rendered are not treated as tax see Hartley v.Walsh ,(1937) 57 C.L.R.372; Crothers v. Sheil,(1933) 49 C.L.R.399.

8. See Cooley, The Law of Taxation, op.cit.pp.83-84.

Court held[9] that this feature was common to both tax and fee, as even in the case of a fee a person cannot escape payment by refusing to avail himself of the privilege, benefit or services rendered. The learned Judge observed that a fee was a payment for a special privilege or benefit derived by the person w by whom it was payable. It was held that when regarded as a return for services rendered the levy must be correlated to the expenses incurred, that is to say, there must be a quid pro quo between the persons who pay the fee and the public authority.[10] It was also held that if the money paid was set apart for meeting the expenses of such service and was not merged in the public revenue for the benefit of public it would be accounted as a fee and not a tax.

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9. A.I.R.(1954) S.C.282,295. The word compulsion denotes absence of contract, agreement or consent of the person who pays the tax or fee. But a person may escape a registration fee on motor vehicles by not having a motor vehicle just the same way as a person may escape liability under the Income Tax Act by earning no income in an year.

10. A.I.R.(1954) S.C.282, 295. Followed in Ratilal Panachand Gandhi v. Bombay, A.I.R.(1954) S.C.388,395; Sri Jagannath v. Orissa, A.I.R.(1954) S.C.400,403.

Applying these tests the Court found that the imposition was not a fee but a tax and hence not authorised by the entries in the State List of the Seventh Schedule as in Lakshmindra's case the collections went into the coffers of the State and the contribution payable was made dependent on the capacity to pay.[11]

Even though a distinction is made between tax and fee, legislative authority is necessary for imposition of both. Though a fee may be imposed by the legislature under any of the entries in the respective legislative list, in the absence of specific authorisation, a levy of fees as subsidiary to a power to regulate an activity would not be inferred.[12] In case where a specific authorisation to impose

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11. This was held to be an attribute of tax, as strictly speaking, in the case of levy of a fee for services rendered a person could not be heard to say that he was unable to pay. See Ibid at 296. A graded levy of fee in accordance with the capacity was held to be not a decisive test in Sri Jagannath v. Orissa, A.I.R.(1954) S.C.400,403. But the fact that such fee is levied at a "certain percentage of the capital value of buildings" would be indicative of the fact that the authority did not intend to correlate the fee with services. See Govt. of Andhra Pradesh v. Hindustan Machine Tools, A.I.R.(1975) S.C.2037,2044.
12. Kerala v. K.P.Govindan, A.I.R.(1975) S.C.152,154; Asa Ram v. The District Board, Muzaffernaggar, A.I.R.(1959) S.C. 480, 483; Balakrishnan v.R.T.A., AIR.(1974) Mad.381.

levy existed, the public authority need only point out the relevant entry in the respective legislative list. In *Maharaja Kishangarh Mills* v. *Kishangarh Municipality*,[13] Wanchoo, C.J., held that every levy imposed by a local body could not be justified under item 5 of List 11,[14] as, if that be so, all that the state government need do in order to provide local bodies with funds was to give them power to levy a fee for the purpose of local government on such basis as might be thought to be reasonable.[15] A fee collected unauthorisedly or under a repealed statute[16] or under invalid bys-laws[17] or

13. A.I.R.(1960) Raj.135(F.B.).A licence fee was imposed on factories under U.P.Municipalities Act,1916.

14. Item 5, List II reads" Local government, that is to say, the constitution and powers of municipal corporations, improvement trusts, district boards, mining settlement authorities and other local authorities for the purpose of local self government or village administration".

15. The learned Judge held that the levy might come within item 36, List III relating to factories.

16. *Abdul Kadir* v. *Kerala*,A.I.R.(1962) S .C.922.

17. *Bhopal Municipality* v. *S.S.M.T.Co.Op.Society*,A.I.R.(1973) S.C.2420; *Lucky Bharat Garage* v.*R.T.A.Raipur*, A.I.R.(1965) M.P.232(where there was power to levy fee for application for permit under the Motor Vehicles Act,it was held that rules could not be framed so as to levy fee for each extended permit); *Mohd.Hussain* v. *Bombay*,A.I.R.(1962) S.C. 97 (where the fee was held to be invalid as the Government had not fixed the maximum rate.).

attempted to be collected without framing bye-laws would be[18] invalid. The power to fix the rate of fees may however be validly delegated by the legislature[19] and in determining the nature of a particular levy the nomenclature given by the legislature is not at all conclusive.[20] The important characteristics of a fee as understood from the decisions of our courts are the following:-

(1) Levied for a particular purpose:-

This distinctive feature of a fee[21] is important as taxes are levied and collected not with a view to spending the money for some particular purpose. But amounts are collected sometimes for defraying particular expenses by way of tax as additional levies, eg. educational cess, health cess etc. These are usually levied either as surcharge on particular taxes or independently of other taxes.

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18. Maharaja Kishangrah Mills v. Kishangarh Municipality, A.I.R. (1960) Raj.185,138.
19. Bajranglal Nandlal v. Commr.,Sales Tax, A.I.R.(1959) All.216
20. Mysore v. P.V.Setty, A.I.R.(1971) S.C.1325,1329; Nizam Sugar Factory v. Bodhan Municipality, A.I.R.(1965) A.P.91.
21. Rajasthan v. Sajjanlal Panjawat, A.I.R.(1975) S.C.706,724.

This distinguishing feature of a fee is also very thin. For example, it is up to the governmentto decide whether particular expenses are to be met by way of taxation from the general revenue of the state or by imposition of a fee upon those who are recipients of such special service or benefit.[22] The problem arises only where the government decides to defray such expenses by the levy of a fee. The particular purpose for which the levy is imposed must always be to defray the expenses incurred for rendering the services by the govenment. In Nagar Mahapalika, Varanasi v. Durga Das,[23] a levy of license fee on rickshaw owners and rickshaw pullers was attempted to be justified as expenses to pave lanes and to light the streets. It was held, that such expenses were in connection with the statutory duty of the Municipal Board and no fee could be imposed to reimburse the cost of ordinary municipal services, which the Board was bound under the statute to provide to the

22. See Seligman, Essays in Taxation op.cit., pp.409-410. In the first case the special benefit is converted into a common benefit shared with the rest of the community.

23. A.I.R. (1968) S.C. 1119. Expenses towards making provisions for parking grounds for rickshaws and that towards salary of the staff maintained for issuing licenses and inspection were upheld. See Ibid at 1125. In Anabeshahi Wine & Distilleries v. Andhra Pradesh, A.I.R. (1972) A.P. 379 it was held that the posting of excise staff in the factory permises was only to ensure prompt payment of tax and that was no service rendered by the State.

general public.[24] But even in such cases where the authority is under a statutory duty to render services with regard to public health and general comfort of the inahitants of the locality, if spacial additional problems are created[25] or if the existing general problems are aggravated by the act of such persons, there seems no legal bar for levying a fee to cope with such circumstances. In such circumstances, it is difficult to apportion the expenses in the absence of specific data and the courts should always be vigilant to see that expense on behalf of general public are not met by receipts of fees.

The particular purpose mentioned above may be in respect of a particular area, class of persons, trade or business though such purpose may indirectly form part of public purpose in general. But in such cases the beneficiary class should be clearly distinguishable from the general public.

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24. This view had been fatal to license fee levied by local authorities. See Sankaran Nair v. Vaniamkulam Panchayat, (1971) K.L.T.264(F.B.); Kannan Devan Mills v. Munnar Panchayat, (1971) K.L.T.348(F.B.); Jeevaraja v. Commr., Badagara Municipality, (1973) K.L.T.845; Meppadi Co-operative Society v. Exe.Officer, ((1972) K.L.T.1065

25. In one case the contention of the authority was that the licensee's trade created the problem of mosquito control. See Jeevaraja v. Commr., Badagara Municipality, (1973) K.L.T.845.

In Hingir-Rampur Coal Co.v. Orrissa,[26] a fund was created by imposing a cess on mine owners to meet the general expenses of a mining area for the welfare of mk mine labourers and the levy was upheld as a fee. Gajendragadkar, J., speaking for the majority observed that if specific services are rendered to a specific area or to a specific class of persons or trade or business in any local area and as a condition precedent for the said services or in return for them cess was levied against the said area, the cess was distinguishable from a tax. It was also held that"if the special service rendered is distinctly and primarily meant for the benefit of a ~~special~~ specified class or area the fact that in benefitting the specified class or area the state as a whole may ultimately and indirectly be nenefitted would not detract from the character of the levy as a fee."[27] It is submitted, that the

26. A.I.R.(1961) S.C.459,464. The expenses were incurred in relation to communication, water supply, electrification and for general welfare of labourers. Wanchoo, J., dissented on the view that the levy was in substance an excise duty which the State Government was incompetent to impose. In V.N.Mohamad v.Gujarat, A.I.R.(1974) Guj.31 it was held, that a license fee taken from exporters of cattle could not be used for the general improvement of cattle wealth in the State.

27. A.I.R.(1961) S.C.459, 466. The court was much influenced by the fact that the collections were not merged into the general revenue of the State but were set apart see Ibid at 467.

decision has introduced unnecessary confusion into the concept of fees. Here the levy was on mine owners calculated in accordance with the value of the mineral extracted. The so-called "service" rendered was in relation to an area and not directly towards the persons who paid the levy. Though the govemnment may spend money in certain cases for rendering special services to a class of persons it cannot take money as a fee from one class of persons and spend it for benefit of another class. The Court could have classified the levy as a "special assessment" on the principle that persons whose property has increased in value by an improvement effected by public authorities should specially contribute towards the cost of the improvement.[28] The only difficulty in classifying the levy as a special assessment is that generally special assessments are levied only on landed property.[29]

Moreover, it is difficult to reconcile this decision with Nagar Mahapalika case. The term" general expenses" cannot mean two things in two cases. On a parity of reasoning, it would seem that had the fee in Nagar Mahapalika case was levied to create a welfare fund for the benefit of rickshaw pullers, it wold have found favour with the Supreme Court.

28. A special assessment is a "compulsory contribution, levied in proportion to the special benefits derived, to defray the costs of a specific improvement to property undertaken in the public interest" See Seligman, Essays In Taxation. op.cit.,p.414. In India such a levy is known by the name betterment levy.

29. See Cooley, The Law of Taxation, op.cit.,p.106.

In India the courts have upheld levy of fees for expenses which are not strictly speaking services. For example, In Commr.H.R.E. v. L.T.Swamiar,[30] the services rendered were inspection, control and auditing of the affairs of the trust. In such cases it is doubtful whether such regulation can be called as service rendered.[31] The maximum that could be said in such cases may be that the regulation of the activities of the trustees was beneficial to the trust property[32] out of which the fee was paid. In Australia a more strict view is adopted in such cases. In Parton v. Milk Board,[33] a levy was imposed on dairymen to meet the expenses of milk board and the levy was held not a fee as no particular service was rendered to the dairymen though

30. A.I.R.(1954) S.C.282.

31. The question of services was originally of only minor importance, But even where medieval monarches exacted fees, such exactions were under the mask of payment for special privileges, the monarch being the Judge of the amount of the benefit. See Seligman, Essays In Taxation, op.cit.,408.

31. Mathew, J., observed in Maharashtra v. Salvation Army, A.I.R.(1975) S.C846, 853, "Taking precautionary measures to see that public trusts are administered for the purposes inteded by the authors of the trusts and exercising control and supervision with a view to preserve the trust properties from being wasted or misappropriated by trustees are certainly special services for the benefit of the trusts".

33. (1949) 80 C.L.R.229.(Dixon, J.)

the court agreed that the activities of the board were beneficial to the milk industry. But such a strict view need not be followed in India as a fee may be levied for giving special services and also for regulatory ~~be levied~~ activities such as inspection, which are imposed in the exercise of the police power or regulatory power of the state.[34] That is to say, the power to regulate being a sovereign attribute and since the expenses in relation thereto were caused because of the activities of certain persons, such expenses may be met by the imposition of a fee.

The object for which a particular levy is imposed would not necessarily serve as a guide to know whether the imposition was a fee or tax. Generally, where the particular levy would fall within the legislative powers[35] to tax, the courts classify the levy as tax and not fee.[36] Only where the

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34. See Cooley, The Law of Taxation op.cit.,p.108. Rajagopala Ayyangar, J., in Corporation of Calcutta v. Liberty Cinema, A.I.R.(1965) S.C.1107,1120 observed "To say that to enable a fee strictly so called to be levied en immediate advantage measurable in terms of money should be conferred on the payer, is to take too narrow a view of the concept of a fee".
35. Whether constitutional with respect to legislatures or statutory with respect to local authorities.
36. See Corporation of Calcutta v. Liberty Cinema, A.I.R.(1965) S.C.1107. Where the Court classified a license fee in respect of cinema theatre, a tax; Corporation of Calcutta v. ~~Smartxcham~~ Sarat Chandra Ghatak, A.I.R.(1959.Cal.704; Ajoy Kumar v. Local Board, A.I.R.(1965) S.C.1561; Jadeja Habhubha v. Bombay, A.I.R.(1959) Bom.43.

levy is not supportable as a tax under the taxing powers, the enquiry begins whether it could be supported as a fee. In an earlier case[37] the Municipality levied license fee on fire wood and charcoal to meet the increased expenditure of education department after going through the formalities prescribed for the imposition of a tax and the court upheld the levy as a tax.

Separate fund

The second test applied by the Supreme Court[38] to determine the nature of a levy was whether the collections were merged in the general revenue or set apart for and appropriated specifically for the preformance of the service. In Lakshmindra's case probably the Court based its decision much on the aspect of non-creation of a separate fund.[39]

37. Sorabji Hormasji Lakdavala v. Borach Borough Municipality, A.I.R.(1941) Bom.268(The license fee on sweetmeat was struck down as no bye law was framed). The Municipality had power to levy an education tax.
38. Commissioner H.R.E. v. L.T.Swamiar, A.I.R.(1954) S.C.282 296.
39. The other ground was that fee was levied not uniformally but according to the capacity to pay, which was held to be an aspect of taxation. But in Ratilal Panchand Gandhi v. Bombay, A.I.R.(1954) S.C.388 and Sri Jagannath v.Orrissa, A.I.R.(1954) S.C.400 such absence of uniformity was tolerated. In Both cases separate funds existed and similar levies were upheld as fees.

In S.T.Swamiar v. Commr.,H.R.C.E.[40] the creation of a separate fund was held to cure the defect in the old Act of 1951. Though creation of a separate fund is one of the characteristics of the levy of fee, it is not conclusive. In Annand Kumar Bindal v. E.S.I.Corporation[41] the contribution payable under Chapter VA of Employees State Insurance Act, was held to be in the nature of a tax though such contributions were ear marked and constituted a separate fund, because under Art.366(28) Of the Constitution tax may be either local or special.

Under Art.266 of the Constitution of India all revenues of Union of India and that of the states must go into the respective consolidated funds and all other public moneys must go into the respective public accounts of the Union and the states. There exists one line of reasoning that where departments of government levy fees such collection ought to go to the consolidated fund of the ~~respective~~ respective

40. A.I.R.(1963) S.C.966. The Hindu Religious Endowment Act, 1951 was amended in 1954 after the decision in Lakshmindra case. The amended Act created a separate fund called Madras Hindu Religious And Charitable Endowment Administration Fund.
41. A.I.R.(1957) All. 136,139(Mootham, C.J.) For similar view are see K.C.Sharma v. Regional Director E.S.I.Corpn.,A.I.R. (1962) Ass.120,124. In Jagadish Prasad v.Saharanpur Municipality,A.I.R.(1961) All.583,a water tax was held to be in the nature of a fee as a separate fund existed. But this view does not seem to be correct. See Nizam Sugar Factory v.City Municipality,Bodhan,A.I.R.(1965) A.P.91; Raza Bul and Sugar Co. v.Rampur Municipality,A.I.R.(1962) All.83.

government.[42] According to this view only where such fee is collected by a separate body like the charity commissioner as in Lakshmindra's case such collections ought to be ear-marked. It is submitted, that an uncompromising insistence on the creation of a separate fund in all cases might not be necessary. It is true that if such receipts are blended with other revenues of the state it loses its identity. In such cases a separate account of such receipts would easily serve the purpose. The real difficulty, according to the present writer, is that no money could be taken out of the consolidated fund without the aid of an appropriation act under Art.266(3). Such a procedure, of course, might bring in also legislative scrutiny in the whole matter. Generally speaking the legislations relating to local authorities contain a section similar to Art.266(1).[43] In two recent decisions,[44] Madhavan Nair, J., expressed doubts regarding the

42. See H.M.Seervai, Constitutional Law of India, (1967), Bombay), p.915.

43. For example, S.13 of Kerala Municipalities Act, 1960 reads so follows" All money received by the Municipal Council shall constitute a fund which shall be called the Municipal fund and shall be applied and disposed of subject to the provisions of this Act or other laws".

44. Travancore Tea Estates v. Executive Officer, (1968) K.L.T. 776,779; Commissioner Municipal council v. S.M.Prabhu, (1968) K.L.T. 628, 630-631. According to the learned Judge the Supreme Court had hitherto no opportunity to consider the effect of such a provision.

effect of such a provisions on the nature of the levy. But in the case of local authorities special powers may exist to create separate funds or assign money for separate use.[45]

Strictly speaking, collections of fee are meant for defraying particular expenses and hence should be kept apart.[46] In two cases the absence of a separate fund was held to be decisive in determing the character of a fee. But in the first case the license fee was levied on the basis of production of bricks (in the nature of an excise duty which the State Government was incompetent to levy) and in the second case there was an express finding that there was no quid pro between the amount levied and services rendered.

The Supreme Court of India has recently held that the creation of separate fund is not essential for the validity of a fee.[47] In Government of Madras v. Zenith Lamps,

45. See Sorabji Hormasji Lakdavala v. Borach Borough Municipality, A.I.R.(1941) Bom.268,270. The collections went into a separate municipal fund.

46. Pravulal Patadia v. Orissa, A.I.R.(1960) Ori.43(license fee for working brick kilns); Delhi Cloth and General Mills v. Chief Commissioner, A.I.R.(1964) Puj.492(a fee under the Registration Act,1908)

47. A.I.R.(1973) S.C.724,733. But this does not mean that such collections can be "merged in the general revenue of the State to be spent for general public purposes". See Mathew, J., in Maharashtra v. Salvation Army, A.I.R.(1975) S.C.846, 851. It is to be noted that such creation of a separate fund will facilitate proof of the fact that funds are not diverted. See D.Hemchand v. Chansma Municipality, A.I.R.(1968) Guj; 38,46; Girija Prasad v. Jaipur Municipality, A.I.R.(1973) Ori.8,11.

the court fees levied by the state governments were held to be a fee even though the collections were merged in the general revenue of the states. The same view that a separate fund is not necessary for the validity of fees has been reiterated in Rajasthan v. Sajjanlal Panjawat,[48] also. It is submitted, that this view is correct even though the Privy council in an earlier[49] appeal from Canada treated the absence of a separate fund of the collections as fatal on the ground that the money raised was no more specially applicable for the administration of justice than any other part of the general provincial revenue.

(3) Quid Pro Quo between the levy and services rendered.

The Chief test in the determination of the character of a levy is that the fees collected should be proportionate to the services rendered. The concept of welfare state is that

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48. A.I.R.(1975) S.C.706,725. Here the devasthanom department was an administrative department and fees taken under Rajasthan Public Trusts Act had to be deposited in the consolidated fund of the State. It was held that, that was not conclusive as to the nature of the levy.

49. A.G.for Qubec. v. Reed, (19884) 10 A.C.141,145.(validity of a levy of fees on exhibits filed in courts was in question).

the state is entitled to make a levy even against the wish of the person sought to be benefitted.[50] Since a person against whom a fee is levied could not refuse payment on the view that he does not require such services, the only remedy available to him is to prove that the collections farexceed the actual expenses. According to Seligman, the test whether collections exceed the cost of particular service can apply only to those fees paid in return for some positive work done by the government. In some cases what the government gives is only a permission to do something, a permission which costs almost nothing, ~~f~~ and for which a considerable fee may be exacted.[51]

50. Satyanarayana Raju, J., in Garimell Satyanarayana v. E.G.C. & T. Marketing Committee, A.I.R.(1959) A.P.398,403.

51. "The controlling consideration here is not cost, but measureable special benefit" Seligmnan, Essays in Taxation. op.cit.,408. In India, the license fee levied by various state governments from venders in country and foreign liquors may be classified in this group. In Har Shankar v. Dpty.Excise & Tax Commr., A.I.R.(1975) S.C.1121,1133 such license fee was held to be the price or consideration which the government charges for parting with its privileges and granting them to the licensees.

It may be stated at the outset that the petitioner will not succeed by simply showing that the collections exceed the cost of services as the law allows accumulation of the fund to an extent.[52] In *Maharashtra* v. *Salvation Army*, it was contended[53] that large surplus was lying with the Government and this rendered the levy a tax. His Lordship Mathew, J., spoke[54] " one should not seek for any mathematical accuracy in these matters but be content with rough approximations". The expenditure in constructing buildings for locating the head office and regional offices and the increase in the allowances or other amenities to staff was held to be included in the costs of the services.[55] His lordship continued " We think that it would neither be expedient nor prudent to lay down any abstract proposition that whenever there is surplus

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52. A.I.R.(1975) S.C.846. The Bombay Public Trusts Act,1950 imposed a levy of fee at the rate of 2% on the income.
53. Rs.84,49,473/- was the accomulated surplus as on 31.3.1970.
54. Ibid at 853.
55. Ibid at pp.853-854. In *Fulabhai* v. *K.D.T.M.Committee*, A.I.R.(1972) Guj.78 the contentions, that the surplus was to be utilised for purchasing lands for the committee and that collections at various centres should be spent there itself and not to subsidise market committees,whose financial position was weak, were rejected.

in a particular year or number of years, that surplus must always be taken into consideration and the rate of the contribution should be reduced for the next year of subsequent years. An organization like the one in question may have to incur capital expenditure for the better administration of the trusts and it might not be able to foresee all the contingencies in which such expenditure will have to be incurred for the more efficient working of the organization". Spending of Rs.30 lakhs to purchase a building to locate the head office was held to be not a diversion of the funds. However, the court held that still there was a surplus of Rs.54 lakhs and without balancing the budget it could not levy further fee. Though money collected by way of fees in one year need not be spend in the same year itself, such funds should not be diverted for some other purpose. In <u>Mukundarayao</u> v. <u>Mysore</u>,[56] S.76(5) of Madras Hindu Religious Endowments Act, which provided that any surplus of fees occuring after meeting the expenses should be used to make grants to poor and needy religious institution, was held to be invalid. In <u>Bhagawandas</u> v. <u>Madhya Pradesh</u>,[57] a statute enacted by the State Legislature to help the poor provided for contribution to a fund by the market committees consistuted under <u>M.P.Agri.Produce Markets</u> Act.1960. The provision was struck down as ultra vises the

56.A.I.R.(1960) Mys.18,23.
57.A.I.R.(1972) M.P.95.

State Legislature as the entire fund of these market committees was from fees levied. The above decisions, it is submitted, cast the burden of proof on the payer of a fee not only to show that the collections were in excess of what was necessary for rendering services but also to show that the diversion, if any, of the surplus was wrong. Expenditure of the surplus for capital investment like purchase of immovable property or buildings, it is submitted, should not be treated as expenditure for rendering services. Such expenditure at least should have a direct and proximate connection to the nature of services rendered. Whether the office of the authority is located in a rented building or not, would not in any way affect the quality of service given to the payer of the fee. It is submitted, that any expenditure, capital or revenue, which would not improve the qality of service should not be permitted by the courts to be charged on the collections of fees.

Firstly, the burden of proof is on the person alleging that the levy is not a fee.[58] But where the levy is excessive to appear as arbitrary this initial burden shifts to the

58. Gopalan v. Varkey Job, A.I.R. (1965) Ker. 216, 218; Brij Mohanlal v. Emperor, A.I.R. (1934) All. 497, 499.

59.

authority.[59] The same is true when it is proved that the authority is rendering no service at all[60] or incurring no additional expenses apart from the ordinary one or when existing levy of fee is enhanced by the authority.[61]

Secondly, it is well settled that the objection to the levy of fee on the ground that it was not commensurate with the services rendered could be raised at any stage including a revision from an order imposing a punishment for non payment of such a fee.[62]

In S.T.Swamiar v.Commissioner H.R.C. & E.,[63] Shah J.,

59. Chandwxlal Jethalal Jayaswal v.Gujarat, A.I.R.(1964)Guj.59. where a Vend-fee of 75 ps, per gallon on french polish and varnish on import came to Rs.1125.

60. Commissioner, Municipal Council, Guntur v. B.V.Rao,(1957) A.P. 103 a fee on persons selling articles on margines of roads. Held, there was no additional expenses other than that incurred on maintaining roads.

61. Muthuswamy Raja v. Kadayanallur Panchayat,A.I.R.(1965) Mad. 289,290 a license fee levied on private markets was increased from 3% of the gross income to 12%.

62. Corporation of Calcutta v. Calcutta Tramways Co.,A.I.R.(1964) S.C.1279, 1283; Brij Mohanlal v.Emperor,A.I.R.(1934) All.497; Kunhambu v,Local Fund Oversee, Chirakkal,(1932) Mad.W.N.873.

63. A.I.R.(1963) S.C.966,975. Here the contribution payable by religious endowments was based on their capacity to pay. This was thought repugnant to the very idea underlying the term fee, i.e. persons who receive same services should pay the authority equally. The argument was repelled by the Supreme Court.

observed that there need only be a direct relation to the actual service rendered by the authority and a levy did not partake the character of a tax because some contributors did not obtain" the same degree of service as others may". The above statement of law makes it clear that a person would not be heard to complain that a levy is not a fee simply because he had paid much more than others and had not received an equivalent(i.e. more service than others) of what he had paid. That is to say, the quid pro quo in fees is not used in the sense it is used in Contract Act.[64]

The decisions whether a levy is a fee or not, considering the quid proquo aspect, is a complex process. In Lakhanlal v. Bihar,[65] the petitioner challenged the legality of the notification declaring the market area and establishment of a market and levy of a market fee and license fee under Bihar Agricultural Produce Markets Act, 1960. The rate of market fee was 25 p. per Rs.100/- worth of Agricultural produce. The contention of the petitioner was that the levy was in the nature of a tax as the element of quid pro quo was absent. Bachawat, J., for the Court observed[66] that the market committee had taken steps for the establishment of a market where buyers

64. Garimell Satyanarayana v. E.G.C.T. Marketing Society, A.I.R. A.P. 398,403 the contention was that the fee levied on commercial crops was actually paid by buyers and the services rendered by the marketing society was beneficial only to growers of such crops. Held the services need not be in mathematical proportion to the amount paid.
65. A.I.R.(1968) S.C.1408.
66. A.I.R.(1968) S.C.1408,1412. The contention was rejected. The license fee also was found to be not excessive.

and sellers can meet and sale and purchase of agricultural produce take place at fair prices and unhealthy market practices are eliminated by defining market charges, ensuring correct weight and measures and disputes settled quickly and cheaply by a dispute committee. A market intelligence unit existed for collection and publication of daily prices and information regarding the stock, arrival and despatches of agricultural produce, a grading unit is provided for grading of produces and the contract form for sale and purchase was standardised and these were held to be services in return.

The study of the quid pro quo element is attempted here on a classification of fees into general and license fees.

I GENERAL FEES.

In this category of fees, a type of receipts generally classified as fees has to be excluded. Cases where the authorities provide public facilities and persons who use the public places for such purposes will have to pay amount generally termed ~~fff~~ fees. Strictly speaking such receipts are not fees as the government, like every other property owner can realise any amount for the use and occupation of its property and such receipts are only in the nature of rent.

In Bhopal Municipality v. S.S.M.T.Co.Op.Society,[67] the appellant Municipality constructed a bus stand and levied fee for the use of the same and the Court held that the appellant might provide for a bus stand and levy any fee from those who make ouse of such facilities as any other owner of the property. In such cases the question of quid pro quo does not arise as collections are not made in the exercise of taxation power though wrongly called "fee". Here an earlier decision of the Supreme Court in Municipal Council Canannore v. Raman Nambiar[68], requires brief mention. The appellant constructed a bus stand on its own land and exacted fees from bus operators. In 1961 the rate of fee per bus was increased from 50 paise to one rupee. According to the respondent the collections(Rs.2500/-) far exceeded the expenses(Rs.381) and lacked the element of quid pro quo.[69] Upholding the contention the levy was struck down. It is

67. A.I.R.(1973) S.C.2420. The Court struck down the orders of the Municipality that every bus should stop at the Municipal bus stand to pick up passengers as the Municipality had no such power under the Motor Vehicles Act,1939.
68. (1969) K.L.T.49. C.A.No.186 of 1966 decided on 10.10.1968.
69. One of the contention urged on behalf of the appellant was that the land if let out would have fetched a rent of Rs.4000/- and this loss should be treated as an item of expenses! Strangely enough, this contention was approved by the Court but held not proved.

submitted, that the decision is wrong[70] as the fee is in this case can only be the rent for use and occupation of premises belonging to the municipality. To classify it as an exercise of the power of taxation was clearly unwarranted. It is even doubtful whether the decision is an authority for the proposition that public authorities can only levy reasonable rent for the occupation of the premises.

Under this category of general fees it is not difficult for the courts to examine whether the fee is commensurate with services rendered. In Government of Madras v.Zenith Lamps,[71] the court fee payable by the litigants in civil courts was held to be a fee, the benefit being the machinery for resolution of disputes and the reasonableness of the fee can be tested against the expenses incurred by the State in the administration of civil justice.[72]

70. In U.S.A. the reasonableness of such rent charges has been examined under the commerce clause In Guy v. Baltimore, (1879) 25 L.Ed.743, 745 Harlan, J., observed"The city of Baltimore, if it chooses, can permit the public wharves which it owns to be used without charge. Under the authority of the State, it may also exact wharfage fees, eqqally, from all who use its improved wharves, provided such charges do not exceed what is fair remuneration for the use of its property". Such payments are only contractual and not claimed by the state by virtue of the sovereign powers.

71. A.I.R.(1973) S.C.724.Earlier the various high courts had taken the view that court fee was a special type of fee see Rahim Khan v.Ghulam Ahmed,A.I.R.(1974) J & K.19.

72. Seligman observes" if a charge is made for the cost of Judicial process, the payment is fee,because of the special benefit, to the litigant".Seligman,Essays In Taxation op.cit.,p.409. See also A.G. for Qubec v.Reed,(1884) 10 A.C.141,144(P.C.).In the case of court fee the person who pays it, does so in the expectation that he may be indemnified when the suit is disposed of by way of costs.

Under this category, the most common and elementary type is where the authority or state does some actual service and levies an amount to meet the expenses. An example may be provided by fees for maintaining light houses levied under Indian Light House Act,1927.[73] Here the state provides for the establishment of light houses in ports and charges a fee based on tonnage of all incoming and outgoing ships to meet the expenses. Here the service element is conspicuous.

The second type of fees which comes under this category is fees taken for the purpose of regulating an activity or to supervise the management of certain institutions in which the general public or a section there of is interested. Fees taken under various hindu religious and charitable endowments legislations[74] may be cited as examples. Here what the state actually does is to appoint a commissioner to supervise the management of such institutions, obviouly to avoid mismanagement and there exist provisions under these Acts, apart from S.92 of Civil Procedure Code,1908,for the removal of trustees

73. It is submitted that to this category may be added fees taken under S.12 of Special Marriage Act,1954 for solemnisation of marriage, fees taken under Indian Registration Act ,and fees taken for copies of Judgment and other documents in courts of Law.According to Findlay Shirass, the special advantage in registration fee in the case of documents and marriage licenses is only secondary,the primary motive being regulation in public interest. See Findlay Shirass, Science of Public Finance(3rd Edn.1936), P.202.

74. The Wakfs Act,1954 providing for creation of a board of Wakf in every state is another example.

who mismanage. In such a case to say that services are being rendered to such institutions, it is submitted, would be far fetched.[75] The prominent element is one of regulation though such regulation of its affairs might be said to be in the ultimate interests of such institutions as nobody wants these institutions to perish at the hands of corrupt people.

The third type of fees which comes under this category is fee taken upon conferring some benefit or privilege. An example is provided by fee taken under S.3 of the Societies Registration Act, 1860.[76] By virtue of such registration the society is conferred with a legal personality and can sue in the name of the society and can be sued also under such capacity.[77] Here also the element of services is

75. The Supreme Court in Commissioner H.R.E. v. L.T.Swamiar, considered the activity of commissioner as services. But the Swamiar, had challenged these services as restrictions on his right to property under Art.19(1)(f) and Court rejected the challenge. See also S.T.Swamiar v. Commissioner, H.R.E., A.I.R.(1963) S.C.966, where his successor was held to have power only to manage property and not to mismanage though in the earlier case the Court had held that he had an interest in the property of the mutt. That is to say, the right to manage is not ordinarily a right to property. Even if it amounts to property right, it is only a right to manage properly and not to mismanage.
76. To this category may be added fees taken under S.58 of Indian Partnership Act,1932 for registration of a partnership, fees taken under Indian Companies Act,1956 for registration of trading or non-trading companies.
77. If the society is unregistered the suit should be brought in the names of all members of the society. See Nalin Behari v. Bisweswar, A.I.R.(1961) Cal .393.

absent as the other type of services are control by the registear and auditing of accounts by him. The fee taken under Patent Act,1970 for the registration of a patent gives a privilege.

The fourth type of fees which comes under this category is the fee taken for registration or enrolment of persons who practice professions such as law, medicine or accountancy.[78] The fee taken in such cases is given to a body who looks after the interests and affairs of the members of the profession. The modern state owes and attempts to perform a duty to protect the public from those who seek one purpose or other to obtain its money. When one does so through the practice of a calling, the state may have an interest in shielding the public against the untrustworthy, the incompetent or the irresponsible.[79] Here also the elements of regulation and control are prominent. The leading case on this point is Chandrakant K.Pradhan v. Jasjit Singh[80]. The Custom House

78. Fee under S.24(1)(b) of Advocates Act,1961; fee under S.30 of Pharmacy Act,1948 for registration as Pharmacists.

79. Jackson, J., in Thomas v. Collins,(1944) 323 U.S.516,545.

80. A.I.R.(1962) S.C.204. In Samsamkaram v. I.G. of Registration, A.I.R.(1969) A.P.134 a fee on document writers was upheld.

Agents Licensing Rules, 1960 provided for a fee of Rs.50/- for issuing fresh licenses as well as for renewal of existing licenses. The duties of agents required them to handle goods at the customs house.[81] The Rules provided for an examination to consider the suitability of the applicant.[82] It was held that though the rate of fee was not excessive for licenses, it was struck down as to renewal of existing licenses.

II. License Fees

The ordinary method of regulation of a trade, business or other activity is by issue of license and generally fee is levied when license is issued. A license and fee stands on a different footing and as pointed out correctly by Mukherjea, J., in Commr., H.R.E. v. L.T.Swamiar,[83] the aspect

81. It seems that the examination fees collected by universities and education boards come under this category as the examination is conducted with a view to test the eligibility of the examinees for particular degrees.

82. A.I.R.(1962) S.C.204,209. Subha Rao, J., concurred on this point though wrote a dissenting opinion on other points.

83. A.I.R.(1954) S.C.282,295.

of service is only secondary in it. In an appeal from Canada[84] Lord Atkin observed " a license itself merely involves a permission to trade subject to compliance with specified conditions. A license fee, though usual, does not appear to be essential".[85] According to Findlay Shirass a license fee is a fee only where the licensee gets special benefit for the privilege and where the license charge is so high as to bring in a net revenue to the public authority, it is a concealed tax. As could be seen the expenses to meet the regulation or to conduct inspection to insist compliance with the conditions set out in the license could not be normally understood as services rendered to the licensee.[86]

84. Shannon v. L.M.D.P. Board, (1938) A.C.708,721. The observation that such license fees may be charges"either to defray the costs of administering the local regulation or to increase the general funds of the Province, or for both purposes" is made with reference to the Canadian Constitution and has no application in India. In India it is well settled that no fee whether general or license can be imposed to augment the revenue of the state. See Nagar Mahapalika, Varanasi v. Durga Das, A.I.R.(1968) S.C.1119,1124.

85. See Findlay Shirass, Science of Public Finance(1936),p. 203.

86. Reed, J., in Poulose v. New Hampshire, (1952) 345 U.S.395 409 observed that the valid requirements of license were for the good of the applicants and the public.See also a warning note by Murphy, J., in Follett v. Mc Cormick, (1943) 321 U.S.573, 579, that taxing and licensing powers were dangerous and potent weapons which in the hands of unscrupulous and bigoted men, could be used to suppress freedoms unless kept within appropriate bounds.

Rajagopala Ayyangar, J., in Corporation of Calcutta v. Liberty Cinema,[87] felt this difficulty and observed that placing of an activity, industrial or commercial, under regulation and control was no doubt done in furtherance of public interest but so were most of the activities of public bodies. Nevertheless, the supervision, inspection or regulation was from a long term point of view considered to be and was in the interests of the industry or the activity itself. According to his lordship "To say that to enable a fee strictly so called to be levied an immediate advantage measurable in terms of money should be conferred on the payer, is to take too narrow a view of the concept of a fee".

The term licensee fee is not conclusive of the fact that the levy is a fee and not a tax. For example, it has been held[88] that the amount collected from the highest bidders to have the right to deal in liquor, though generally termed a license fee, is only the amount collected by the state for the grant of privilege to deal in liquor.

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87. A.I.R.(1965) S.C.1107,1128.

88. Panna Lal v. Rajasthan, A.I.R.(1975) S.C.2008,2012; Har Shankar v. Deputy E. & T. Officer, A.I.R.(1975) S.C. 1121,1133; Nashirwar v. Madhya Pradesh, A.I.R.(1975) S.C. 360,367.

The state under its police power has the power to regulate any trade, business or occupation by the issue of a license in order to protect health, morals and welfare of the general public. In such cases it is usual to levy a fee to cover the reasonable expense of such regulation. In U.S.A., the prevailing view[89] is that such license fee is levied in exercise of the police power rather than the power of taxation. This view cannot be supported as, though the power of taxation may be utilised to achieve regulation of an activity, namely in aid of police power, the use of police power to raise revenue is not permissible. It is submitted, that even in U.S.A., the position of law is that such exaction of license fee is for purposes of meeting the cost of regulation, inspection and police control and if the collections exceed the expenses the levy is treated as a tax.[90] The law in U.S.A., is different as there in cases of harmful or non-useful business or trade, which the legislature may absolutely prohibit under its police power, a license fee so exorbitant so as to be prohibitive can be imposed for the purpose of revenue.[91] The law in

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89. See Cooley, The Law of Taxation op.cit.,96,3508-3509. See Seligman, Essays in Taxation op.cit., pp.402-405 for a criticism of the view.
90. See Cooley, op,cit. pp.3513-3514. In this sense the law is same as in India, the only difference being that in India the levy of a fee is considered to be a manifestation of taxing power and in U.S.A., it is considered to be a manifestation of police power.
91. See Cooley, The Law of Taxation, p.3555.

U.S.A., was referred to by Ramaswami, J., in Nagar Mahapalika v.Durga Das,[92] and this has led the various high courts in India to hold that revenue can be raised incidental to regulation of an activity.[93] It is submitted, that the reference to the law in U.S.A., was unnecessary in the context of the case, as under the Indian Constitution, the power to levy a fee is not incidental to the general legislative power, but is authorised specifically by the Constitution. Hence it follows that when the state intends to regulate an activity by the issue of a license, it may also invoke the power of taxation to impose a fee to cover the expenses of such regulation.

The license fee differs from an ordinary fee as here the imposition is to meet expense of regulation and not to render any service. A license fee should be reasonable and the collections should in no case exceed the cost of regulation. That is to say, in the case of license fee there must be quid pro quo between the collections and the expenses incurred by the authority in issuing the license and of inspecting and regulating the business it covers.

92. A.I.R.(1968) S.C.1119, 1125. See a recent reference to police power to levy license fee in Kerala v.Govindan, A.I.R.(1975) S.C.152,154.
93. See Uttar Pradesh v. Bharat Nath, A.I.R.(1973) All.187; Fulabhai v. K.D.T.M.Committee, A.I.R.(1972) Guj.78; Ramachandran v.Kerala, A.I.R.(1971) Ker.146. See also Narayana Pillai, J., in Govindan v.Kerala,(1972) K.L.T. 73,80.

With regard to the requirement of quid pro quo, in any early case Municipal Corpn. of Rangon v. Panzundaung Bazar Co.Ltd.[94], it was contended that the licensing authority may charge as license fee only the cost of the papers on which the license and receipts were printed, together with the cost of printing and writing on it and the cost of such inspection as was directly connected with the licenses themselves. This extreme contention was rejected and it was held that a license fee might reasonably cover the cost of all special services unnecessitated by the duties and liabilities imposed on the Corporation in respect of supervision and regulation of private markets. That the license fee should bear as nearly as possible a relation to the cost of issuing the license and the cost of supervising the trade or of any special measure rendered necessary by the character of the trade is a well established proposition and only in this context, it is submitted, the quid pro quo element could be considered.[95]

94. A.I.R.(1930) Rang.282,286.(Heald,Off.C.J., and Mya Bu,J.) This statement of law was approved by the Privy Council in Panzudaung Bazar Co. v. Municipal Corpn., A.I.R.(1931) P.C.217,220. The decision was concerned with the validity of a license fee for private markets. In an earlier case, Municipal Corpon. v. Sooratee Bara Bazar Co., A.I.R. (1927) Rang.183 the license fee at the rate of Rs.10/- per 100 sq.ft. of floor area was struck down by the Rangoon High Court. Later the Corporation calculated the total amount of expenses for regulation and supervision of private markets(Rs.12,308) and allocated the same among licensees of private markets on the basis of rateable value respectively. This system of levy was upheld in Panzudaung Bazar Co.case.

95. See Corporation of Madras v.Spencer & Co.,A.I.R.(1930) Mad.55; MUnicipal Council, Kumbhakonam v. Ralli Brothers, A.I.R.(1931) Mad.497 (a fee for storing groundnuts.)

Recently, a full bench of the Kerala High Court in Sankaran Nair v. Vaniamkulam Panchayat,[96] considered the validity of the levy of a license fee on private markets at the rate of 33⅓% of the gross income from the market. It was contended on behalf of the respondent Panchayat that the expenses incurred for the supervision and control over these markets and giving water facilities to the markets were sufficient quid pro quo for the levy of the license fee. Gopalan Nambiar, J., speaking for the Court rejected this contention on the view that these were statutory duties which the Panchayat was bound to discharge and did not necessitate the maintenance of any additional or special staff charged with the duty of supervision and control of private markets alone. The larned judge pointed out that the Panchayat had not cared to furnish any data regarding the expenses incurred by it.[97] But for the statement of Nambiar, J., regarding absence of data, it is difficult to support the view that the establishment of a market did not create fresh problems and additional expenses to the local authority. In Indian Mica and Micanite Industries v. Bihar,[98] the Supreme Court had occasion to comment on the negligence on the part of the persons in charge of the affairs

96.(1971) K.L.T.264; see also Girija Prasad v. Jaipur Municipality, A.I.R.(1974) Ori.12 a case of license fee on private markets.

97.See other instances where the levy was struck down for absence of data, Kannan Devan Hill Produce Co. v. Munnar Panchayat,(1971) K.L.T.393(F.B.); Uttar Pradesh v. Dist. Registrar,Meerut, A.I.R.(1971) All.390.

98.A.I.R.(1971) S.C.1182,1188.

of the state. Here the appellant, a consumer of denatured spirit e in large quantities, was required to take out a licence under the Excise Act on payment of fees and that was challenged as exorbitant and not related to any service given by the State. On ~~B~~ behalf of the State it was contended that persons in possession of denatured spirit might attempt to make it fit for human consumption and such a process being[99] injurious to the excise revenue of the State, it had to employ supervisory staff and chemical examiners to carry out these obligations of supervision and control. Rejecting the contention[100] it was held, that in such a case the State was protecting its own rights. It is submitted, that if such denatured spirit which is unfit for human consumption is made fit for human consumption in large quanities and by the use of such liquor the health of people are affected, the State has certainly a duty to meet such a ~~sw~~ situation by deploying additional staff and the levy of license fee could not be challenged on the ground that what was given was not any service but only control.

99. Whether such a process was injurious to the health of persons consuming the same and thus injurious to public health was not at all raised or answered.

100. Ibid at 1187.

The question whether services would comprise controls and restrictions put on the licensee was squarely put, but not answered in Delhi Cloth and General Mills v. Chief Commr., Delhi.[101] Here the appellant had to pay a license fee at the rate of Rs.2000/- for each of its factories. It was contended that the inspectors appointed under the Factories Act had wide powers and the exercise of such powers could in no sense be called to be services rendered to the owners of the factory. The factory inspector had wide powers to deal in circumstances where it appeared to him that any building, machinery, plant etc., was in a condition dangerous to human life. These provisions were interpreted by the Court to say that such inspectors were expected to give proper advice and guidance and thus the owners mught be saved from the consequences of the working of dangerous machines by timely warning from these Inspectors. It is submitted, that this type of far fetched logic was unnecessary to decide this case as those provisions are made in the interests of general public. The term 'service' ought not to be interpreted in a[102] narrow or pedantic sense. The observation by Grover, J., "Indeed it seems to us that the nature of the work of the inspector is such that he is to render as much, if not more service than a Commissioner would, in the matter of supervision, regulation and control over the way in which the management of the trustees of religious and charitable

101. A.I.R.(1971) S.C.344.
102. Ibid at 348.

endowment was concerned" was with respect to Sudhindra Thirtha Swamiar v. Commr., H.R.E.[103] But in that case the fee an was payable by the mutt or trust and the control and supervision on the trustee could well be said to be in the interest of such trusts. The reference to Second Shirpur Mutt case, it is submitted, was unwarranted and misleading. The impression one obtains from reading the judgement in Delhi Cloth and General Mills case is that the fee should correlate to any services rendered to the payer himself and not to any other person.[104]

There w are cases where the existence of a particular activity, trade or business created special problems, For example, the existence of a factory in a locality would create problems of sanitation, heavy traffic etc. Generally speaking such problems come under the general duties of a local body and has nothing to do with the controlled or licensed activity and the licensee would be entitled to avail of such services by virtue of his position as an ordinary tax payer. When such industry or activity involved special sanitary precautions, a special supervising agency or such like expenditure, it was

103. A.I.R.(1963) S.C.966
104. Such a statement of law could not be correct as in Hingir-Rampur Coal Co. v. Orrissa, A.I.R.(1961)459 the collections from mine owners were utilised for the benefit of workers and the levy was upheld.

held reasonable to take a that expenditure, also into account[105] in fixing the amount of fee. Thus it was held in Kunhambu v. Local Fund Overseer, Chirakkal,[106] that license fee collected for plying motor vehicles under Local Board's Act could be used (1) to the cost of licensing staff and supervision (2) as a fee for the use of District Board's roads for private project and (3) to the actual extra cost of District Board in wear and tear of roads by the use by heavy vehicles. In the earlier Rangoon case[107] the cost of conservancy services to private markets was left out from the expenses to be met by levy of license fees. In the Chirakkal case, the court found that the levy had to be divided between the Board which issued the license and Municipalities within or through whose limits the buses were permitted to run and it was concluded that it showed the inclusion of not only cost of issue of license and supervision of traffic but something in the nature of a return to them on whose roads vehicles run.[108] The underlying principle of the above decisions, that the creation of special problems necessitating extra cost would entail a ~~im~~ valid levy of license fee to cover such expenses, it is

105. India Sugar & Refineries Ltd. v. Municipal Council, Hospet, A.I.R.(1943) Mad.191,192.(Wadsworth and Patanjali Sastri, JJ. (The licensees were held to be engaged in an offensive trade). It was laid down that the Court should not declare a fee or levy to be ultra vires merely because it was some what higher than what might have been thought necessary on a different view of facts see at p.193.

106. (1932) Mad.W.N.873,895.Wallace, J., on a difference of opinion between Waller, J., and Krishnan Pandalai, J.

107. Municipal Corporation v.Sooratee Bara Bazar Co.,A.I.R. (1927) Rang.183.

108. See Krishnan Pandalai, J., in (1932) Mad.W.N.873,884.

submitted, still holds good.

In the leading case on this point Nagar Mahapalika, Varanasi v. Durga Das Bhattacharya,[109] the appellant Municipal Board levied license fee of Rs.30/- on rickshaw owners and Rs.5/- on drivers of rickshaws under certain bye-laws framed by it. It was argued that in license fees the tax element was predominant and it was not necessary to show any relation between the levy and expenses incurred in rendering services.[110] Rejecting this contention, it was held that the U.P.Municipalities Act,1916 contemplated only two types of levies,

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109. A.I.R.(1968) S.C.119. The appeal was taken to the Supreme Court from the decision of Allahabad High Court in Durga Das v. Municipal Board, A.I.R.(1962) All.277. (Jagdish Sahai and Bishambar Dayal, JJ.,by a majority struck down the fee as unreasonable. Desai, C.J., dissented.) Ramaswami, J., speaking for the Supreme Court upheld the majority view. This was a case of increase of license fees on rickshaws.

110. The contention was that in such cases where the authority grants a privilege or permission to do something,which those persons would be incompetent to do, it can extract fees either heavy or moderate. It is submitted, that the argument should hold good in certain cases where what is granted is a real privilege(such as the license to supply electricity generated by the state) but not in the present case, as plying rickshows by no stretch of argument could be said to be enjoying a privilege or doing something, which if done without permission would be illegal. Here only the element of regulation is present and the decision of the Supreme Court, it is submitted, rightly negatived the contention.

namely a tax and a fee and not third king of levy of license fee in the nature of tax. Since the procedure laid down for imposing a tax was not followed the Court held the levy to be only a fee. Items of expenses under the heads, paving of bye lanes(on which only rickshaws could operate) and lighting of streets and lanes were held to come under general statutory duties and were disallowed. The other expenses came only about to 44% of the collections and the levy was held to be illegal.

It is submitted, that the item of expense for paving bye lane, through which only rickshaws could have operated, ought to have been allowed as an expense to be met from the collections of the license fee. Whether this item of expense was increased by the use of rickshaws alone was not at all inquired into(neither any evidence seems to have been let into) and if the answer of such enquiry is in the affirmative, the doctrine of special expenditure as described above,[111] would have applied.

111. See India Sugar ~~and~~ Refineries Ltd. v. Municipal Council, Hospet, A.I.R.(1943) Mad.191. This decision was cited with approval by the Supreme Court for the principle that the Municipality would not be justified in increasing the license fee chargeable upon a particular industry merely by reason of the increased cost of ordinary municipal services. See A.I.R.(1968) S.C.1119, 1125. The Additional cost in Varadachari v. Madras, A.I.R. (1952) Mad.764 was that there were complaints of adulteration of oil by public and the State had to appoint additional inspectors to check it and that cost increased the fee for oil mills. The increase was held illegal.

Regarding the tests to determine the presence of quid pro quo in license fee, Reilly, J., in *Corporation of Madras* v. *Spencer & Co.*,[112] held that the firstly the costs of issuing the license, inspecting the premises to see whether they are suitable for the purpose proposed and subsequent inspection of the premises to see that they are used properly and that conditions and restrictions imposed in the license are obeyed, could be met by the collections of the license fee. This first test is the one applied by our courts to see whether license fees are reasonable or not. Secondly, where different licenses are issued to persons carrying different trades or occupations, what is exactly the cost of any particular license or of licenses for persons engaged in particular trades or occupations would be difficult to calculate. In such cases according to his lordship it would be unreasonable if they so fixed the fees that the whole or a heavy disapproportionate burden is incurred by a particular class alone.[113] What is practicable in such a case is to allocate it among different types of licenses according to some reasonable formula.

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112. A.I.R.(1930) Mad.55,59,60. The appellant Corporation increased the license fee for storing spirits from Rs.25/- to Rs.200/- The Court found that the fee was raised not because of the expenses of collection and regulation but as a "counter demonstration, to the order of Government refusing to allow the Corporation to take the abkari revenue of the City"(Philips, J.) at p.58.

113. In *Municipal Council, Kumbakonam* v. *Ralli Brothers*, A.I.R. (1931) Mad.497. The license fee for storing groundnuts was the highest being Rs.100/-. The fee for storing other articles was below Rs.30/-. The levy was held to be a tax in disguise.

An interesting question which arose with regard to license fees was whether separate fee was leviable for storing different articles in the same premises or for using the same premises or machinery for different purposes. In Chinthamoni Sahu v. Cuttack Municipality[114], the Orissa High Court held that it would be unreasonable. This decision was distinguished and notfollowedd in a later case, Harrisons & Corssfiled v. Municipal Council, Kottayam[115], as one based on the harshness and unreasonability of the levy. In the Kerala decision it was held that license issued with regard to a purpose and separate levy was not inconsistent and the contrary view; it was held, would be absurd. In the absence of strong evidence as to the unreasonability of such fees, there is nothing wrong in levying such fees for different purposes because the quid pro quo is between the total collection and the total expenses and the individual is not at all in the picture. But in a later case, Travancore Rayons v Municipal Council[116], an exeception seems to have been carved out

114. A.I.R.(1955) Ori.175.
115. A.I.R.(1958) Ker.69 where different licenses had to be taken for stering tea and rubber in the same premises.
116. A .I.R.(1958) Ker.149(F.B.). License fee of Rs.100 was levied for manufacturing rayon and transparent paper.

of the above decision. In the Travancore Rayons Case it was held that rayon and transparent paper were different [117] products of the same manufacturing process and in such a case, it was held that to amount to a double levy. Whether it did involve separate regulation and supervision and expenses different from or in addition to the manufacture of the other commodity was neither contended for nor examined and as such could not be accepted as to lay down a general rule of law.

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117. It was held that the same viscose solution when pressed through a nozzle became rayon yarn and when passed through a narrow slit became transparent paper.

CHAPTER VI.

TYPES OF TAXES (Contd.)

Taxes on Property

Under the Constitution of India the power to impose tax on property is not exclusively given either to Union Parliament or state legislatures. The allocation of taxing power in the legislative lists is not by way of scientific or logical definition but by way of a mere simple enumeration of broad categories.[1] Entry 86, List I of the Seventh Schedule to the Constitution gives power to the Parliament to impose taxes on the capital value of assets, exclusive of agricultural land, of individuals and companies and taxes on the capital of companies. Under this entry the Parliament has enacted The Wealth Tax Act, 1957 to impose tax on the capital value of a person's net wealth. Entry 49, List II gives power to the state legislatures to impose a tax on lands and buildings. Being an under developed country, in India generally a person's wealth is in the form of lands and buildings. Since tax on lands and buildings may be imposed either on the basis of its annual value or capital

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1. See Ramaswami, J., in Asst.Commr., Madras v. B & C. Co., A.I.R.(1970) S.C.169,175.

value,[2] a lot of cases have arisen as to the true scope and content of these two entries.

A tax on property is a tax levied by reason of the ownership or possession of property- a tax on the right to property itself. The tax on gifts and the tax on inheritance though not taxes on property as such, are included in this chapter as these taxes are levied on the basis of the value of property transferred by way of gift or by reason of the death of a person.

The tax on the capital value of the assets under entry 86 of the Union List differs from the tax on lands and buildings under entry 49 of the State List in the following respects. Firstly, under entry 86 of the Union List the tax is on the capital value of the entire assets of a person, which may include lands and buildings also and not on the components of the assets.[3] Secondly, under entry 86 of the Union List, any encumbrance or liability specifically charged

2. Prithvi Cotton Mills v. Broach Municipality, A.I.R.(1970) S.C. 192,196; Mammad Keyi v. W.T.O., Calicut, A.I.R.(1962) Ker.110 114; Muni.Commr.,Ahmadabad v.Gordhandas Hargovindas, A.I.R. (1954) Bom.188,191.(The last cited decision was reversed on another point in Gordhandas Hargovindas v. Muni.Commr., Ahmadabad,(1963) S.C.1742.)

3. Sudhir Chandra v.W.T.O., A.I.R.(1967) S.C.59,61.

against an item of asset has to be deducted in arriving at the capital value for the purpose of taxation.[4] In the case of atax under entry 49 of the State List even where the capital value is adopted as the basis of the tax, any encumbrance or liability to which such land or building is subject need not be deducted.[5] However, these two taxes may be of the same nature where a persons total asset consist of only lands and buildings and no liability is outstanding on such property.[6]

In certain exceptional cases, where a person owes no debts and is under no enforceable obligation to discharge any liability out of his assets, it may be possible to break up the tax which is leviable on the total assets into components and attribute a component to lands and buildings ~~owned~~ owned by an assessee.

4. The general liability of the assessee to pay his debts is also taken into account. See Asst.Commr: Madras v. B. & C.Co., A.I.R.(1970) S.C.169,175.

5. Sarkar, J.,(dissenting) In Gordhandas Hargovindas v. Muni. Commr., Ahmedabad, A.I.R.(1963) S.C.1742, 1755.

6. cf. Asst.Commr.Madras v. B & C.Co., A.I.R.(1970) S.C.169, 175.

WEALTH TAX.

Wealth tax under entry 86, List I is leviable on the capital value of all assets excluding agricultural land. But there is no corresponding entry in List II authorising state legislatures to impose a tax on the capital value of agricultural land. Whether the Constitution makers really intended to put agricultural wealth beyond the reach of taxation of both the Union as well as the states was a debatable point. The Wealth Tax Act as enacted in 1957 contained a specific exception regarding agricultural lands and this resulted in hoarding of much unaccounted money in agriculture.[7] In 1969 the Wealth Tax Act,1957 was amended so as to include the capital value of agricultural land also. This has been upheld by the Supreme Court in Union of India v. H.S.Dhillon,[8] It has been held[9] that the word" individual" in entry 86, List I included a joint hindu undivided family also. In this case the taxable event is ownership of property or assets and such ownership will be deemed to continue till it is

7. See H.C.L. Merillat, Land And The Constitution In India (1970), p.81 .

8. A.I.R.(1972) S.C.1061.

9. Banarasi Dass v. W.T.O., Allahabad, A.I.R.(1965) S.C.1387, 1392.

divested. Hence the tax on capital value of assets ~~exif~~ is of a recurring nature from year to year.[10]

TAX ON LANDS AND BUILDINGS.

The tax under entry 49, List II on lands and buildings is a typical source of revenue to the local authorities in this country. ~~Entrustment-of-this-tax-to-the-local-authorities-in-this-country.~~ Entrustment of this tax to the local authorities does not divest the state legislatures of the power to impose this tax for its own revenue.[11] In Asst.Commr. Madras v. B.&. C.Co.,[12] it was held that the legislative history of entry 49, List II did not lend any support to the argument that such tax could not be separated and imposed separately on the lands or buildings. In Jagannath Baksh Singh v. Uttar Pradesh,[13] a tax on agriculture holdings was upheld under this entry. The same view was taken by the Madras High Court in

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10. See V.R.B. Narayanamurthy v.Commr. Wealth Tax,A.I.R.(1964) Ori.128, 132.
11. See Kasthurchandji v. Madhya Pradesh,A.I.R.(1967) M.P.269; Ram Pratap v. Punjab, A.I.R.(1963) Punj.354,357. The question was left undecided by Govindan Nair, J., in N.Kunhali Haji v. Kerala, A.I.R.(1966) Ker.14,16.
12. A.I.R.(1970) S.C.169,177. The contention was that tax should be on both land and building and not on any one of them only.
13. A.I.R.(1962) S.C.1563,1568; See H.R.S.Murthy v. Collector of Chittoor, A.I.R.(1965) S.C.177 the land cess was held to come under this entry. See also Ajoy Kumar v.Local Board, Barpeta, A.I.R.(1965) S.C.1561,1563.

Mohd. Ismail v. Agri.I.T.O., Mannargudi,[14] where the tax when compounded under the Act was provided to continue for three years irrespective of annual income and was upheld under entry 49. In P.R.Rajah v. Kerala,[15] it has been held that a tax on forest land was valid under this entry, but does not include a texon machinery.[16]

In a very early case the Federal Court of India[17] held that a tax on lands and buildings based on annual value was valid and was not a tax on income. Other bases used for the imposition of this tax are capital value,[18] market value[19] and total floorage of buildings.[20] Generally, annual value

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14. A.I.R.(1964) Mad.556,560. A general water tax has been held to be a tax under this entry in Nizam Sugar Factory v. Bodhan Municipality, A.I.R.(1965) A.P.91,94 and Raza Buland Sugar Co. v. Rampur Municipality, A.I.R.(1962) All.83,86.
15. A.I.R.(1963) Ker.31,& 42.
16. New Maneck Spg. & Wvg.Mills v.Ahmedabad Municipality A.I.R. (1967) S.C.1801,1814.
17. Ralla Ram v.East Punjab, A.I.R.(1949) F.C.81,85-86.
18. Mohammd Keyi v. W.T.O.,Calicut, A.I.R.(1962) Ker.110,114.
19. Asst.Commr.Madras v. B & C.Co., A.I.R.(1970) S.C.169,176; followed in Spencer & Co. v. Mysore, A.I.R.(1971) S.C.1321.
20. Bhuvaneswariah v . Mysore , A.I.R.(1965) Mys.170,178(Hegde, J.).

is adopted as the basis where the premises is actually let out or is capable of valuation and the capital value or market value[21] is adopted as the basis where the plot of land is lying vacant. It has been held[22] that where the basis adopted is annual value of the premises, the fair w rent fixed under the rent control legislation must be taken into account.

The tax on lands and buildings is leviable on both the owner and the occupier of the property. Thus in one case[23] the court has upheld the levy by the Municipality on its own tenant.

Tax on Gifts.

The tax on gifts made by a person is complementary to estate duty as such gifts made during the life time of a person tend to reduce the estate and the duty thereon. Since gifts are generally made out of love and affection in favour of near relatives, the tax on gifts also acts as a deterrent to accomulation of wealth in the family. The Constitution

21. For the difference in meaning of these expressions See Raman Nayar, J., in Kadija Bai v.W.T.O.Mattancheri, A.I.R. (1969) Ker.69, 71-72.
22. Guntur Municipal Council v. Guntur Town Rate Payer's Assn., A.I.R.(1971) S.C.353, 354; Corporation of Calcutta v. Padma Debi , A.I.R.(1962) S.C.151,156.
23. B.R.Betgeri v. Hubli Dharwar Muni.Corpn., A.I.R.(1971) S.C.1427.

contains no specific legislative entry dealing with tax on gifts and hence the legislative power falls under the residuary power of the Parliament.[24]

The Gift Tax Act,1958 imposes tax on all gifts made by a person subject to certain exemptions under Sec.5. Such exemptions include gifts made for charitable purposes and gifts made to relatives, subject to certain maximum prescribed amounts. The Act also ropes in certain transactions where property is transferred for inadequate consideration.[25] The tax is payable in the first instance by the donar and if it cannot be recovered from him it may be recovered from the donee. The liability of the tax arises for gifts made in each year.

Succession Duty and Estate Duty.

The tax on succession is of very ancient orgain and is also known as 'legacy' or inheritance tax. The term succession duty may be defined[26] as a tax on the privilege of

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24. Second Gift Tax Officer v.D.H.Hazareth,A.I.R.(1970) S.C.999.
25. See S.4. It has been held that if the manager of a joint hindu family, throws his self-acquired property in the common property of the family, such act would not amount to gift liable to tax under the Act. Goli Eswariah v. Gift Tax Commr., A.I.R.(1970) S.C.1722.
26. Cooley,The Law of Taxation op.cit., p.3440.

of succeeding to the inheritance or of becoming beneficiary under the will. The tax attaches to all property received by a person whether by operation of law, by will, or by gifts mortis causa. The right to succeed to the property of a deceased person is not a natural or inherent right, but is considered to be a privilege subject to regulation by the state. The succession duty is not a tax on the property succeeded to, the volume of property being only the measure of the tax.[27] It is said that the succession duty commonly, employs a series of rate scales that vary with the degree of relationship of the heir to the deceased.

The Constitution of India has conferred the power to tax succession to non-agricultural property on Union Parliament[28] and the power to tax sucession to agricultural property on state legislatures.[29] Neither the Parliament nor any state legislature has levied the tax in India.

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27. International Encyclopedia of The Social Sciences, Vol. XV, p.555. According to Bentham all types of intestate succession should be abolished except in the case of near relatives and in the absence of near relatives the property should go to the state. Bentham, Collected Works(Re Browning's edn.), Vol.II.p.586.
28. The entry 88 of the Union List reads: "Duties in respect of succession to property other than agricultural land".
29. The entry 47 of the State List reads:"Duties in respect of succession to agricultural land".

The estate duty is a tax on the value of the property forming the estate irrespective of succession. The estate duty differs from succession duty as in the case of the former the tax falls on the whole estate of the deceased, while in the case of the latter, tax falls on the respective shares of the persons who succeed to such property. The underlying principle of both these taxes is same, namely, the prevention of accumulation of wealth within the same family from generation to generation and these taxes are considered to be a little oppressive as the liability arises at the most painful period in the life of a family.

The Constitution of India has divided the power to impose estate duty on non-agricultural property and agricultural property[30] between the Union Parliament and the state legislatures[31]. The Union Parliament has enacted the Estate Duty Act,1953 which levies the tax both on agricultural and non-agricultural property and the law has been adopted byall the state legislatures under Art.252. The Estate Duty Act imposes the tax on property passing on the death of a person including property which the deceased was competent to dispose of, any benefit or interest ceasing on the death of the person,gifts mortis causa, etc.

30. The entry 87 of the Union List reads" Estate duty in respect of property otherthan agricultural land".
31. The entry 48 of the State List reads" Estate duty in respect of agricultural land".

CHAPTER VII

TYPES OF TAXES (Contd.)

TAXES ON COMMODITIES

Tax on Sale or Purchase of Goods.

The entry 54 of List II of the Seventh Schedule of the Constitution provides for "taxes on the sale or purchase of goods other than news papers subject to the provisions of entry 92-A of List I". The entry 48 of List II of the Seventh Schedule of the Government of India Act,1935 did not contain the word" purchase" but it has been held[1] that a tax on purchase of goods fell under that entry also. The tax under this entry is imposed on goods, the taxable event being the sale or purchase of such goods. Normally a purchase ~~ax~~ tax is levied only on goods which are consumed by manufacture or exported out of the state. In such a case the very act of purchase[2] by a manufacturer or an exporter attracts the liability to the tax[3]. Normally, the sales or purchase tax is imposed in relation to the sale price but it may be imposed on the basis of the weight of the goods purchased or sold.[4]

The term 'goods' has[5] been defined in Art.366(12) of

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1. V.M.Syed Mohammed & Co. v. Andhra Pradesh, A.I.R.(1954) S.C.314, 315.
2. Sri Venkateswara R.G. & G.O.M.C.Co. v.Andhra Pradesh,A.I.R. (1972) S.C.51,53 .
3. A tax on purchase of goods used in the manufacture of goods is not excise duty Devi Dass v. Punjab, A.I.R.(1967) S.C. 1905.
4. Andhra Sugars Ltd. v. Andhra Pradesh,A.I.R.(1968) 599,606.
5. The term may also include animals and birds , Abraham v.Asst. S.T.O.,A.I.R.(1960) Ker .360.

the Constitution of India as "goods include all materials, commodities and articles". This definition being inclusive was held to be not exhaustive in Maharashtra v. Champlal Krishnlal Mohota,[6] where it was held that timber trees agreed to be served and sold under the agreement were "goods" for the purpose of sales tax under the state sales tax legislation. In an earlier case Madras v. Gannon Dunkerley & Co.,[7] it has been held that the term" sale of goods" in entry 54, List II had the same meaning as in Indian Sales of Goods Act, 1930 and that the state legislatures could not enlarge the meaning. The Sale of Goods Act, S.2(7) reads" Goods means everykind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be served before sale or under the contract of sale". In A.V. Meiyappan v. Commr., Comrl.Taxes,[8] it was held that the term "goods" would include incorporeal moveable property such as a copy right.

6. A.I.R.(1971) S.C.908,910.
7. A.I.R.(1958) S.C.560. The Parliament and the Legislature of Jammu & Kashmir are not restricted in such a way. See Mithan Lal v. Union of India, A.I.R.(1958) S.C.682; Instalment Supply (Pvt) Ltd. v. Union of India, A.I.R.(1962) S.C.53; Hindustan Const.Co. v. Ass.Authority, A.I.R.(1970) J.& K. 85,86.
8. A.I.R.(1969) Mad. 284, 291. In S.T.Commissioner, Indore, v. M.P.Electricity Board, A.I.R.(1970) S.C.732 electric energy was held to be "goods".

The term sale has been held[9] to contain the following characteristics, namely (1) parties having capacity to contract, (2) mutual agreement between them for the purpose of transferring title to the goods, (3) money consideration and (4) passing of property in the goods by virtue of the transaction.

Regarding the requirement as to parties having the capacity to contract, it could be said that where the goods belonged to the person who later consumed or appropriated it, no question of sale could arise. Thus where property of a firm was distributed among partners on dissolution of the firm no sale occurs as the goods belonged even before such distribution to the members.[10] The same result should follow when a club or unicorporated association supplied goods to its members.[11] Where such body is an incorporated one having capacity to hold property, even though such body deals exclusively with its members only and claims to make no profit at all, any transfer of goods from such a body to its members would,

9. See Madras v. Gannon Dunkerley&Co., A.I.R.(1958) S.C.560 567; Hindusthan Steel Ltd. v. Orissa, A.I.R.(1970) S.C.253, 256.
10. See Gujarat v. Ramanlal Sankalchand & Co., A.I.R.(1965) Guj.60,65.
11. cf. Shah J., in Dy.Comml.Tax Officer v. Enfield India Ltd., A.I.R.(1968) S.C.838,842 observed that such transaction might not prima facie be regarded as a sale in the case of an unregistered body.

it was held in Dy.Commrl.Tax Officer v. Enfield India Ltd.,[12] attract the liability of tax. The facts in the above decision were as follows. The respondent was a registered co-operative society having the object of providing a canteen for the employees of Enfield India Ltd. The sales tax authorities assessed on its turnover from refreshments supplied to its members[13]. It was held that there was nothing in the record of the case to show that the society was acting merely as an agent of its members in providing facilities for making food available to the members. It was also held that nor could it be said that the society was holding its property including refreshments prepared by it for supply to its members as a trustee for its members. The property held by the society, which was a body corporate with power to hold property, was held to be the property of the society. But in a later decision Joint Commrl. Tax Officer, v. The Young Mens's Association,[14] the Supreme Court of India has deviated from the position of law stated in Enfield India Ltd. decision. The Young Men's Assn. case was concerned with certain non profit earning clubs which supplied refreshments to members. These clubs happened to be registered clubs except one Lawley Institute which was a private trust. As such it is clear that the case falls within

12. A.I.R.(1968) S.C.838(Shah,Ramaswami and Bhargava, JJ.).
13. Ibid at 841.
14. A.I.R.(1970) S.C.1212. In K.S.G.I.P. & Society v. Gujarat, A.I.R.(1972) S.C.1786 it was held that where a society of farmers merely sells the cotton as an agent there was no sale between the farmers and the society.

the ambit of the decision in Enfield India Ltd., case.S.2(n) of Madras General Sales Tax Act read with Explanation 1 to the sub section made transfer of property involved in the supply of goods by a club or society to its members for cash, whether in the course of business or not, a deemed sale. Grover, J., speaking for the majority held[15] that the question to be answered was whether there was a transferof property involved in the supply of refreshments by the club to its members. It was held that the club, even though a distinct legal entity, was only acting as an agent for its members and the element of sale was absent. His lordship Shah, J., who was a party to the former decision wrote a separate concurring opinion basing strongly on the finding by the High Court that there was no transfer of property belonging to the club and it was only acting as agent for and on behalf of the members.

The decision in Young Men's Assn.case, it is submitted, has made the position of law on this point uncertain. The judgment did not indicate the tests to determine the cases when a registered body could be said to act as an agent and when it was not acting in such a capacity. The fact that such clubs or associations have to function in accordance with the wishes of the majority of members requires no authority

15. Ibid at p.216. The majority consisted of Hidayatullah, C.J., Hegde, Grover, Ray and Dua, JJ.

and is true of all such entities including a joint stock company.

The second constituent of a sale is mutual agreement between the parties for the purpose of transfering title to the goods. In Madras v. Gannon Dunkerly Co.,[16] it was held that in a building contract the agreement was that the contractor should construct as agreed to on a specified sum and there was no contract to sell materials used in the construction nor did the property pass in the movables. It was held, that no sales tax could be levied by the state where the transaction was indivisible and where agreements for the sale of materials as distinct from contracts for work and labour could be spelled out, the state can levy sales tax. The decision whether a particular contract is one for sale of goods or one of contract for works would depend on the construction put by the court on the agreement.[17]

16. A.I.R.(1958) S.C.560; see also Pandit Banarsi Das v. Madhy Pradesh, A.I.R.(1959) S.C.909; Punjab v. Associated Hotels (1972)1S.C.C.472(consolidated charges for stay and food in a hotel.
17. See Gujarat v. Kailash Eng. Co., A.I.R.(1967) S.C.547,549 where a contract for building coaches on chasis supplied by railway was held to be a works contract and in Patnaik & Co. v. Orissa,A.I.R.(1965) S.C.1655, 1662 a contract to build bus bodies on chasis supplied by the customer was held to be a contract for sale of goods. See also Commr.Comrl.Taxes v.Hindustan Aeronautics, A.I.R. (1972) S.C.744.

A series of decisions on the requirement as to mutual agreement have been handed over by the Supreme Court of India. That is to say, in a case of compulsory acquisition, the element of bargain to constitute sale is absent and could not be a sale.[18] In New India Sugar Mills v.Commr.of Sales Tax, Bihar,[19] the appellant supplied sugar in accordance with the directions issued by the controller under Sugar and Sugar Products Control Order, 1946 and the question was whether such supply was a 'sale' attracting the liability to pay tax.[20] The majority of the Court held that there was no sale because of the ~~questionx~~ compulsion. The minority took the view that consent, offer and acceptance could be implied as the parties carried on trade under control at fixed price. In a later decision Indian Steel & Wire Products Ltd. v. Madras,[21] the minority view in New India Mills case was approved. Here the appellant supplied steel products to various persons at the direction of the steel controller at specified prices. It was held that because the law imposed certain restrictions on freedom to contract it would be incorrect to say that there was no contract at all and that so long as mutual assent was not completely excluded in any dealing, in law, it was a contract. The same view as to fetters on freedom of contract was reiterated in Andhra

18.See on this point Kirkness v.John Hudson & Co.,(1965)A.C. 696,707 (Viscount Simonds).
19.A.I.R.(1963) S.C.1207.
20.Ibid at 1212.
21.A.I.R.(1968) S.C.478 (Hegde, J).

Sugar Ltd. v. Andhra Pradesh.[22] In Chitter Mal Narain Das v. Commr.Sales Tax,[24] the sale of wheat by a licensed dealer to the State under U.P.Wheat Procurement(levy Order,1959 was challenged as not liable to tax. It was held in that case that it was not merely a regulation of freedom of contract but the actual obligation to deliver arose out of the statute and no question of violation arose as for any such violation. the persons could be penalised. As such it was held that it was not a sale liable to sales tax.

The position of law on this point was fully examined in Salar Jung Sugar Mills v. Mysore,[25] by a constitution bench of the Supreme Court consisting of seven judges. The question was whether supply of sugar cane by growers of a specified area to a particular sugar factory under an agreement in compliance with the provisions of various sugar control orders regulating supply of sugar cane amounted to sale for the purpose of taxation. It was held that[26] there was no absolute prohibition on the freedom to enter into contract and that legislative measures or statutory provisions fixing the price, delivery, supply or restricting areas for transactions were all within the realm of planningeconomic needs ensuring production and fair distribution of essential commodities and basic necessities of community. The transaction was held to be 'sale' within the meaning of Mysore Sales Tax Act.

22. A.I.R.(1968) S.C.599(Bachawat, J.) the Court referred to the whittling down of laissezfaire concept by the theory of welfare state at 604.
23. A.I.R.(1969) S.C.343(Shah,J.).
24. A.I.R.(1970) S.C.2000.
25. A.I.R.(1972) S.C.37.(Ray,J.); Commr.Sales Tax. v. Ram Bilas Ram Gopal, A.I.R.(1970) All.518.523,525.
26. Ibid at 98.

Where the agreement is not to transfer title in the goods, the transaction would not be liable to tax. In <u>Meiyappan</u> v. <u>Commr. Commrl. Taxes</u>[27], a lease of the right to distribute a cinematograph film for 49 years was held to be a lease and not a sale attracting the liability of tax. So also there is a distinction between a sale where the price was payable by instalments and a hire purchase agreement[28] as in the former the purchaser cannot rescind the contract as the property passes as soon as the sale is made even though the price is not fully paid. In <u>K.L. Johar & Co.</u> v. <u>Deputy Comrl. Tax Officer</u>,[29] it was held that a hire purchase agreement had two aspects namely, an aspect of bailment of goods subject to the hire purchase agreement and secondly, an element of sale which fructifies when the option to purchase is exercised by the intending purchaser. The attempts by the State legislature in making an agreement or transaction in which the property did not pass from the seller to the buyer a sale, was held to be beyond the legislative competence. It was also held that only when the agreement ripens into a sale the transaction could be taxed. The same result happened when the U.P. Legislature attempted to tax forward contracts in <u>S.T. Officer</u> v. <u>Budh Prakash Jai Prakash</u>,[30] as a forward contracts is one for the delivery of goods at a future date and is often speculative.

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27. A.I.R. (1969) Mad. 284.
28. See <u>Sundaram Finance Ltd</u>. v. <u>Kerala</u>, A.I.R. (1966) S.C. 1178.
29. A.I.R. (1965) S.C. 1082, 1088; see also <u>Marikkar Motors Ltd</u>. v. <u>S.T.O., Trivandrum</u>, (1966) ~~S.C. 459~~ 2 S.C.W.R. 502.
30. A.I.R. (1954) S.C. 459.

Regarding the requirement as to money consideration it has been held that a barter was not sale and could not be taxed.[31]

The nature of the sales tax being on the sale of goods is considered popularly as an indirect tax which could be passed on the buyer and not to be borne by the seller. But the Constitution did not make any distinction between direct and indirect taxes and there would be no infirmity even if the burden of tax was not capable of being passed on.[32]

Excise Duty

The word "excise" is stated in the Oxford Dictionary to have been originally "accise", a word derived through the Dutch from the late latin "accensare", to tax, the modern form, which ousted "accise" at an early date, being apparently due to a mistaken derivation from the latin "excidere" to cut out".[33] According to Dr. Johnson it is a hateful tax levied on commodities and adjudged not by the common judges of property but by wretches hired by those to whom the excise is paid, a definition distinguished by acerbity rather than precision.[34] G.F.Shirase defines excise duty as a tax on home[35]

31. S.T.C., U.P. v. Ramkumar Agarwal, (1967) 19 S.T.C.400 (Bullion & manufacturing charges accepted in exchange of gold ornaments); Pratap Chand v. Uttar Pradesh, A.I.R.(1964) All.285.
32. See J.K.Jute Mills v. Uttar Pradesh, A.I.R.(1961) S.C.1534 1539.
33. See Gwyer, C.J., in Inre C.P.Motor Spirit Act, A.I.R.(1939) F.C.1,6.For another account of the history of this tax see Sulaiman, J., in A.I.R.(1939) F.C.1,15.
34. See Atlantic Smoke Shops Ltd. v. Canlon, (1943) A.C.550, 564-565(Viscount Simon L.C.)
35. See Findlay Shiras, Science Of Public Finance op.cit, Vol. II. pp.653-654. According to Shiras the tax may be collected at the stage of raw material or intermediate stage of production or when goods are ready for consumption in accordance with the cannon of convenience.

produced goods either in the process of their manufacture or before their sale to consumers. In the United Kingdom the term is understood to comprise taxes on certain specified goods produced or manufactured inside the country and also certain license fees and payments for access to places of entertainments.[36] In Australia excise duty is one analogous to customs duty imposed upon goods either in relation to quantity or value when produced or manufactured, and not in the sense of a direct or personal tax.[37] In U.S.A., the term excise has acquired a special meaning as an indirect tax and generally taxes other than capitation tax,poll tax and property tax are treated as excise taxes.

In India, to start with there was some conflict of judicial opinion regarding the nature of this tax. Entry 45 of List I of the Seventh Schedule to the Government of India Act,1935 which corresponded to entry 84, List I of the Seventh Schedule to the Constitution of India used the expression" manufactured or produced in India" with certain exceptions. The question was whether the expression "manufactured or produced in India" was descriptive

36. See Peterswald v. Bartley,(1904) 1 C.L.R. 497,509(Gifth, C.J.).

37. See Cooley,-The Law of Taxation op.cit., pp.1671-1672; 71 Am.Juris.2d.p.361.

of the goods or used as the basis of incidence of tax. That is to say, whether any tax on goods produced or manufactured in India could be excise or that whether the incidence of excise tax could be only manufacture or production. In the leading case on this point In re C.P.Motor Spirit Act,[38] the issue was whether a tax on retail sale of motor spirit and lubricants by the Provincial Government was in the nature of excise duty and hence ultra vires the Provincial Legislature. Gwyer, C.J., and Sulaiman, J., were of the opinion that excise was a tax on goods on production or manufacture though collected at any stage found to be most convenient and lucrative by the authority.[39] On this view both the judges classified sales tax as a

38. A.I.R.(1939) F.C.1, An advisory opinion given by the Federal Court of India.

39. Gwyer, C.J., held that excise could be levied at any stage before the goods became part of the general stock of Province. Ibid at 11, Sulaiman, J., held that except probably at the stage of first sale excise duty and sales tax were different. Ibid at 25.

distinct tax, but left open the question as to the validity of sales tax on first sale of an exciseable article by the manufacturer or producer. The other Judge Jayakar, J., was of the view[40] that the expression "manufactured or produced in India" was only descriptive of the term" goods" and was not used as the basis of incidence and according to his lordship the term excise duty included all levies imposed on an excisable commodity at any stage from production to consumption except on sales. Jayakar, J., was of the view that even a tax by province on the first sale of an excisable commodity was valid.[41] In later decisions[42] the term excise has been understood as a tax on home made goods on their production or manufacture. Recently in Shinde Brothers v.Dy.Commr., Richur,[43] the learned counsel for the department put forth the proposition that every duty on goods produced or manufactured in India is excise duty unless it is established that it is some other duty. This proposition, it could be seen, was that laid down by Jayakar, J., in the reference opinion. The contention was negatived by the Court without much discussion observing that it was contrary to what had been consistently laid down by the Court. But it is submitted that this point was not seriously considered in any of

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40. Ibid at 35.
41. Ibid at 40.
42. See Sinha C.J., In re Sea Customs Act, A.I.R.(1963) S.C. 1760,1776; Suba Rao, J., in R.C.Jall v.Union of India, A.I.R.(1962) S.C.1281, 1287.
43. A.I.R.(1967) S.C.1512, 1519-1520.

the decisions by the Court and the point requires reconsideration.

The decisions considered by the Supreme Court to have laid down the law that excise was a tax on production of goods were R.C.Jall v. Union of India,[44] and In re Sea Customs Act[45]. The R.C.Jall case was concerned with coal cess on coal and coke despatched from Collieries. The cess was collected as a surcharge onfreight by railway authorities generally from the consignor where the freight charges were prepaid and if not so prepaid,form the consignee. The contention of the appellant was that the excise duty being a tax on production could never be collected from the consignee. The Court held that the method or machinery of collection had nothing to do with the validity or incidence of the tax. It is submitted that this part of the judgement is difficult to appreciate. If excise is really a tax on production of coal, it should be levied on the producer and not on the consumer and if collected from the consumer he should be able to recover the tax from the producer. But being an indirect tax such recovery is out of question. But if the other view, that excise was tax on goods produced within the country, was adopted this sort of verbiage and confusion could have been avoided.

44. A.I.R.(1962) S.C.1281.
45. A.I.R.(1963) S.C.1760.

In *In re Sea Customs Act,*[46] the question was whether the Parliament could amend the Central Excise and Salt Act to levy excise duty on goods produced by the states in India in view of Art.289(1) which provided that property and income of a state shall be exempt from Union taxation. The majority of the Court took the view that what was exempted was a tax on property and not any tax on incidents of property. On this view, the majority was of the opinion that only a tax on goods as such and not on any of its incidents was prohibited. So the question whether excise was a tax on goods or a tax on any of its incidents was directly posed for answer. The majority took the view that excise was not a tax on goods as such , but on the manufacture thereof, and hence only a tax with reference to the goods. As such this is a decision in which a contrary view has been taken. But, it is submitted, that the opinion in this advisory reference was taken without a discussion on this point and it seems to proceed on concession without any argument.

The difficulty which arises because of the view that the excise was a tax on manufacture of goods was brought forth in *C.J.Patel* v. *Union of India*[47]. Here the original rate of levy of excise duty on tobacco in the budget ~~pax~~ proposal

46. A.I.R.(1963)S.C.1760,1774.

47. A.I.R.(1962) S.C.1006,1018.

was increased when the budget was finally passed. The Government attempted to realise the balance from tobacco manufacturers who disputed their laibility with respect to goods already sold away. It was contended by the appellants that the levy could not be passed over to the consumers as goods were already transferred and as such, the manufacturer would have to bear the tax himself. Rejecting this contention, it was held that if Parliament could levy excise duty prospectively it could also be levied retrospectively. It was also held that the duty need not be capable of being passed over.[48] But it is submitted that being an indirect tax the capacity to pass over the tax to the consumer is the hall-mark of such a levy. It does not matter if the manufacturer prefers to bear the tax himself owing to competitive market.[49] But there ought not to be any legal impediment or it should not be an impossibility as happened in the above case. Let us examine the case in accordance with the view that excise duty is a levy on goods produced in India not being a sales tax or any other levy of such nature as octroi etc., and if so no one would be heard to say that he is not liable to pay excise duty if he has meddled with the goods. The only thing he would be pemitted to contend would be that the levy was some tax other than excise.

48. See Sinha, C.J., in In re Sea Customs Act, A.I.R.(1963) S.C.1760,1776.
49. For such a case see British India Corpn.v. Collector, Central Excise, A.I.R.(1963) S.C.104,106.

It is submitted, that the legislative practice in India in this matter of collecting the tax from the producer or manufacturer is not conclusive as being only a method of collection[50] nor is the definition of the tax given in standard works of public finance, conclusive in this matter. In fact, Lord Simonds in Governor General in Council v. Province of Madras,[51] observed that the term duty of excise was a somewhat flexible one. "It may, no doubt cover a tax on first and, perhaps, on other sales: it may in a proper context have an even wider meaning". In fact prior to the Constitution the term excise duty was widely understood as a levy primarily collected from producer and Hidayathullah, J. (dissenting) has correctly pointed out in Shinde Brothers v. Dy.Commr, Raichur,[52] that it was ~~aii~~ in R.C.Jall v. Union of India,[53] that the Supreme Court approving the earlier decisions which laid down that excise was primarily a levy on producer or manufacturer, held that excise was duty on production of goods. The gloss put in R.C.Jall case has been followed in later cases without any further discussion. For example, in J.R.G.Mfg.Assn. v. Union of India,[54] the question was whether rubber cess, which was in the nature of excise duty on rubber, could be imposed on the manufacturers of rubber chappels- consumers of the product. It was held that

50. See Gwyer, C.J., in In re C.P.Motor Spirit Act, A.I.R. (1939) F.C.1,13.
51. A.I.R.(1945) P.C.98,101.
52. A.I.R.(1967) S.C.1512,1527.
53. A.I.R.(1962) S.C.1281, 1287.
54. A.I.R.(1970) S.C.1589,1593.

ia the incidence of the duty certainly fell directly on production or manufacture of goods. But how it fell directly on production of rubber the Court did not answer.

The xx view that the expression" duty on production" was used by oversight rather than deliberately is fortified by the decision in Abdul Kadir v.Kerala[55], where Wanchoo, J., observed[56] " It may therefore be accepted that a duty of excise is a tax on goods produced or manufactured in the taxing country. It may also be accepted that generally speaking the tax is on the manufacturer or producer, though it cannot be denied that laws are to be found which impose a duty of excise at stages subsequent to the manufacture or production". In R.C.Jall v. Union of India[57], this decision was not even adverted to.

The other features of excise duty were discussed by the Supreme Court in Shinde Brothers v. Dy.Commr.[58], where it was held that the shop rent paid by bidders in akbari auction was not excise duty[59], but only the price paid for the privileg of selling liquor. Sikri,J., speaking for the majority

55. A.I.R.(1962) S.C.922. The question was whether the extension of Central Excise & Salt Act,1944 to Travancore-Cochin State repealed the corresponding law, Cochin Tobacco Act.
56. Ibid at 926. See Shah, J., also at 930.
57. A.I.R.(1962) S.C.1281.
58. A.I.R.(1967) S.C.1512.
59. Followed in P.Ramachandran v.Kerala,A.I.R.(1971) Ker. 146,(F.B.)

observed[60] that firstly, there ought to be uniformity of incidence, secondly, the duty must be closely related to production or manufacture of goods and thirdly, that if an article has already borne the duty in some form, there must be clear terms in the statute to indicate that the further levy was also in the nature of excise duty. The same view that such lump sum payments were not excise duty but only payments for the privilege of selling liquor or in consideration of the temporary grant of monopoly was taken by Gwyer, C.J., in <u>In re C.P.Motor Spirit Act</u>,[61] reference also. This view may also be fortified with reference to item 16 of Schedule 1 of Devolution Rules framed by Government of India under Section 45-A of Government of India Act, 1919. It read "Excise, that is to say, the control of production, manufacture, possession, transport, purchase and sale of liquor

60. A.I.R.(1967) S.C.1512,1520-1521. Bachawat, J., concurred. It was conceded that another levy, namely, tree tax was in the nature of excise duty, Ibid at 1516,1519; see <u>E.R. Jose</u> v. <u>Kerala</u>, (1973) K.L.T.463.

61. A.I.R.(1939) F.C.1,12.

and introxicating drugs, and the levying of excise duties and license fees on or in relation to such articles(emphasis supplied). It is submitted, that the distinction between excise duty on liquor and license fees is well established even prior to the Constitution.

The duty of excise is different from sales tax whether it be on the first sale or not,[62] from a tax on purchase of goods used in the manufacture of excisable goods,[63] from a tax on goods transported through highways or waterways[64] and is different from a tax on the sale or consumption of electricity.[65] Since the tax is levied on production of goods, a person who produces goods for his own use is liable to pay the duty.[66] The cess levied under the Produce Cess Act has been held to be in the nature of excise duty.[67]

62. Governor General in Council v.Province of Madras,A.I.R. P.C.98,101; Madras Province v.Boddu Paidanna,A.I.R.(1942) F.C.33,35; Shiva Dayal v.S.T.C., A.I.R.(1951),All.858.
63. Nabha Rice & Oil Mills v.Punjab, A.I.R.(1963) Punj.549,552.
64. H.P.Barua v.Assam,A.I.R.(1955) Ass.249.
65. J.C.Mills v.Madhya Pradesh,A.I.R.(1963) S.C.414,416.
66. Aluminium Coal Corporation of India v.Coal Board,A.I.R. (1957) Cal.326.
67. Raja Oil Mills v. Union of India,A.I.R.(1969) Ker.176,177.

CHAPTER VIII

TYPES OF TAXES (Contd.)

TAXES ON INCOME

Income Tax.

The income tax is a tax on income which means the gain derived from the capital, labour or from both. The term income is not susceptible to a precise definition and the Income Tax Act, 1961, only described the various sources of income. The term has been defined[1] as a periodical monetary return coming in with some sort of regularity from definite sources. But such definitions do not control the constitutional power of the legislature to tax any profit or gain which actually accrues to a person or received by him.

In India tax on income was first levied during the year 1860. The Constitution of India has divided the power to tax income and has conferred the power to tax non-agricultural income on Parliament[2] and the power to tax agricultural income on the state legislatures.[3] This dichotomy between

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1. Sir George Lowndes in C.I.T. v. Shaw Wallace & Co., A.I.R. (1932) P.C.138,140. On this view receipts in the nature of windfalls are excluded from "income".
2. The entry 82, List 1 reads" Taxes on income other than agricultural income".
3. The entry 46, List II reads: "Taxes on agricultural income".

agricultural and non-agricultural incomes for the purpose of taxation can be traced to the year 1886. The then reason for the exclusion of agriclutural income from taxation was the existence of land revenue. The Constitution does not define the term 'agricultural income' but has empowered by Art.366(1) the Parliament to define the term.[4]

The income from land used for agricultural purposes is agricultural income.[5] Sale is not an essential ingredient of the tax, and hence the use of the agriculture produce by the agriculturist himself will not absolve him from the liability to tax.[6] All income which are not agricultural income are taxable by the Union Legislature.

The tax on income satisfies the condition of the ability to pay because the tax falls only on the pecuniary benefits accruing to a person and is in that sense a progressive tax. The charge of income tax is on the total

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4. See S.2(1) of Income Tax Act,1961.
5. The mere connection of the income with agriculture would not render it agriculture income,for example, the salary of the manager of agricultural farm. Premier Construction Co. v. C.I.T., A.I.R.(1949) P.C.20,22.
6. Dooars Tea Co. v. Agri.C.I.T.,A.I.R.(1962) S.C.186.

income of a person. If such person is resident[7] in India such total income includes all income received or deemed to be received in India and which accrues or arises in India or outside India. In the case of a person who is not ordinarily resident in India, income which accrues or arises outside India shall be included in the total income only if such income is derived from a business controlled in or a profession set up in India. In the case of a non-resident, only income received or deemed to be received and that accrues or arises or deemed to accrue or arise in India are included in the total ~~xxxxx~~ income.

Under the Income Tax Act,1961, the levy is on the total income of the previous year relevant to the year of assessment. The total income is the aggregate income from salaries, interest on securities, income from house property, profits or gains from business or profession, capital gains and income from other sources.The income tax payable by joint stock companies is classified as corporation tax.[8]

7. The termsresident and not ordinarily resident are defined by S.6 of Income Tax Act,1961.

8. See definition under Art.366(6).

Tax on Profession, Trade and Business.

Tax on trade and profession is one of the oldest means of revenue to the local authorities.[9] As the name indicates, the liability to tax arises as soon as a person sets up a profession or business even though he earns no income or even runs into losses.[10] But usually the income earned by a person is taken as the basis for the assessment of the tax.[11] It has been held that the basis of the tax cannot be the goods produced in the case of a producer as that would partake the character of excise duty.[12]

Under entry 60, List II to the Seventh Schedule to the Constitution the tax should be on profession, trade, calling and employments. Hence the legislature cannot tax a different activity or transaction under this head. In Ram Narain v. Uttar Pradesh,[13] the Supreme Court had to consider the nature of "circumstance and property tax" under U.P.

9. M.H.Beg, J., in Sushil Chander v. Uttar Pradesh, A.I.R.(1969) All.317,328 observed that the tax belonged to a period when the modern system of income tax had not been developed and adopted.
10. Zila Parishad v. Jugal Kishore, A.I.R.(1969) All.40,42.
11. The paid up capital value of a company can be the basis for levying the tax. Calcutta Chemicals Co. v. Bhagalpur Municipality, A.I.R.(1962) Pat.465.
12. See Mohanlal Hargovind v. Gram Panchayat, Nagod, A.I.R.(1962) M.P.136,138. It is submitted, that this view is not correct as the settled view is that a basis adopted for imposing tax would affect the nature of tax only if the connection between the tax and the basis is fanciful or indirect.
13. A.I.R.(1957) S.C.18,23. Tax on advertisement is not a tax on profession Ismail & Co. v. Kerala, A.I.R.(1965)Ker.237,239. Tax on entertainments is not a tax on profession. Srinivasa Murthy v. Mysore, A.I.R.(1959) S.C.894,896; Delite Talkies v. Jabalpur Corpn., A.I.R.(1966) M.P.298,300. A tax on Cochin stocking tobacco is not a tax on trade. T.K.Abraham. v. Travancore-Cochin, A.I.R.(1958) Ker.129,134.

Municipalities Act and the Court held that the word"circumstance" meant a man's financial position, his status as a whole, depending, among other things, on his income from trade or business and thiswas held to be covered by entry[14] 60, List II. In Velu v.Executive Officer,[15] it has been held that pursuit of agriculture was an exercise of a calling. In C.Rajagopalachari v.Corpn. of Madras,[16] it was held that the receipt of pension would not fall under any of these heads and was not liable to tax. The same view has been taken with respect to income from investments in buildings by the Kerala High Court.[17]

Art.276(1) provides that a law relating to tax on profession, trades, callings or employments shall not be invalid on the ground that it relates to a tax on income. The sub-caluse(2) of Art.276 provides that the total amount of such tax payable by any person to the state or to/one any

14. Zila Parishad v.Jugal Kishore,A.I.R.(1969) All.40,42 for the view that it may fall under some of the entries in the State List. See Mohammadabad Muni. v. Sri Ram, A.I.R.(1970) All.561,570.
15. (1967) K.L.T.350.
16. A.I.R.(1964) S.C.1172,1178.
17. Subhadra Kovilamma v. Kerala,(1970) K.L.T.586,588.

local authority shall not exceed two hundred and fifty rupees per annum.[18] It has been held that the state government and the local authority may each impose such a tax not exceeding two hundred and fifty rupees per year.[19] This restriction has been imposed on the power of the state legislatures because the tax on profession or trade is mostly imposed on the income from such profession or trade and is similar to the federal income tax imits impact. Under the proviso to sub clause (2) of Art.276 where any such tax was in force immediately prior to the commencement of the Constitution it could continue to be levied until Parliament made provisions to the contrary either generally or in relation to a particular state or local authority. Thus any tax on profession exceeding Rs.250/- could be valid only if it was validly levied and collected prior to the Constitution.[20]

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18. Under the Government of India Act,1935, the maximum amount prescribed was fifty rupees. See S.142A.
19. Kamta Prasad v. Executive Officer, Ballabgarh, A.I.R.(1974) S.C.685.
20. See Gajadhar Hiralal v. Basin Municipality, A.I.R.(1958) Bom.378(An increase in the rate of tax prior to the Constitution was invalid and hence not saved by the proviso).

The constitutional history of this provision requires a brief mention. Prior to the Constitution of India a similar provision had been enacted in S.142-A of the Government of India Act,1935. Under that Section the maximum amount that could be validly levied was Rs.50/- . But the federal legislature was empowered to validate any existing levy which was realised at a higher rate. S.142-A was enacted on 31-1-1940 and it came into operation with effect from 1.4.1939. Thus it could be seen that there should have been a valid existing levy on March 31,1939 in order that the federal legislature should continue it.[21] The federal legislature enacted the Profession Tax Limitation Act,1941 which exempted imposts made under certain legislations.[22] Hence so far as the old British India was concerned a levy exceeding Rs.250/- could be valid only if it was covered by the provisions of Professions Tax Limitation Act, 1941.[23] With regard to territories comprised in former princely states no such limitation existed prior to the Constitution.

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21. Municipal Committee,Akot v. Manilal Manekji,A.I.R.(1967) S.C.1201.1204.
22. Such as Calcutta Municipalities Act,1922, United Provinces Municipalities Act,1916, Central Provinces Municipalities Act,1922 etc. The rationale upon which Art.276 was enacted was stated to be to validate the exercise of power conferred upon local authorities to impose tax on the basis of income prior to Government of India Act 1935. See Mudholkar,J., in Bharat Kala Bhandar v.Dhamangaon Municipality, A.I.R.(1966) S.C.249; P.C.Mahehwari v.Zila Parishad,A.I.R.(1971) S.C.1696,1700.
23. See E.M.Lakhani v. Malkapur Municipality,A.I.R.(1970) S.C. 1022. The increase in rate was made in 1940 and it was held that the levy was not within the protection of Art.276

An imposition of tax on profession, which was valid under S.142-A of Government of India Act,1935 or saved by the Professions Tax Validation Act,1941[24] could be continued under the Constitution of India. The constitutional sanction is only for continuance of such levy[25] and any increase in the rate of tax or increase of amount of tax by the change of the basis of tax is invalid.[26] In *Mst.Jadao Bahuji* v. *Municipal Committee, Khandwa*,[27] a tax which was invalid was validated in 1941 after the commencement of S.142-A of Government of India Act,1935, retrospectively from a date prior to March 31, 1939 and that was held to cure the defect.

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24. See *Manohar Rao Gangadhar* v. *Muni.Council Pandhurna*, A.I.R. (1966) M.P.235, 239.(a tax on pressing and ginning cotton).
25. *Manilal Manekji* v *Muni.Committee, Malkapur*,A.I.R.(1963) Bom.3(it was held that though the power to increase the rate of tax existed it was not saved and what was saved was only the existing rate); *Muni.Committee, Karanja* v. *New East India Press Co.Ltd*.,A.I.R.(1949) Nag.215(increase of tax after March 31, 1939); *District Council, Bhandara* v.*Kishori Lal*,A.I.R.(1949) Nag.190.(increase of rate of tax from April,1,1942.
26. *Commr., Quilon Municipality,* v.*Harisson & Crossfield Ltd*, A.I.R.(1965) S.C.1174. Prior to 1950 the tax was assessed on the basis of computation of income under Travancore Income Tax Act, under which only the income which accrued in that State was taxable. After 1950, the basis was changed to that under Indian Income Tax Act and the income that accrued or arose in whole of India was the basis of tax.It was held that the amendment went beyond formal alterations.
27. A.I.R.(1961) S.C.1486. The tax on ginning and pressing of cotton was imposed in 1922 and was held to be invalid in *Radhakrishnan* v. *Municipal Committee,Khandwa*, A.I.R.(1934) P.C.62.

CHAPTER IX.

TYPES OF TAXES (CONTD.)

CUSTOMS AND OCTROI DUTIES

Customs Duty

The Customs duty is a tax imposed at the point of passage of goods into or out of a country[1] and includes export and import duties. It is a trading tax and though not imposed on the intangible act of importation or exportation but on goods, it is not a tax on property.[2] The Constitution of India confers the power to impose customs duty, on Parliament of India.[3] In India, the customs duty is levied under the Customs Tariff Act,1975 read with the Customs Act,1962 and is of two types-ad valorem and specific. Since the liability arises on importation or exportation of goods, such liability attaches to the goods even if such goods are transferred to other persons if duty is not paid.[4]

Historically, this tax is of ancient origin and is seen to have been levied by countries which had foreign trade relations.[5] In England the power to levy customd duty had been

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1. On this view even if goods were not actually landed in the port and were transhipped again, customs duty can be levied. cf.Wilson v. Chambers & Co.,(1926) 38 C.L.R.131,138.
2. Sinha,C.J., In re Sea Customs Act,A.I.R.(1963) S.C.1760,1777.
3. The entry 83 of the Union List reads: "Duties of Customs including export duties".
4. cf.Wing On And Co.Ltd. v.Collector of Customs,(1938) 60 C.L.R.97.
5. In ancient Rome, portoria (port duties) was comprised of customs duties and ~~tax~~ tolls.

regarded as a matter of royal prerogative[6] and not a matter of taxation requiring the consent of Parliament.

The power to levy customs duty is generally understood to be a measure to regulate the foreign trade of the nation and the Customs Tariff Act, 1975 confers the power on the Central Government to impose preferential rates and protective duties to provide for protection of indigenous industries from unhealthy competition of foreign goods and as a convenient device to divert trade in particular directions.

OCTROI

Historically, the levy of octroi can be traced back to the Roman times when the cities were allowed to levy 'portoriah', a tax on the entry of the goods into or departure from a province. In India the levy of octroi seems to be as old as the times of Manu.[7] The word octroi is a french term derived from "octroyer" which literally means to grant[8]. The term is used to denote a duty collected by the local authorities on goods brought within its precincts for consumption by the inhabitants. The duty attaches only to goods of outside origin entering the city and not to goods produced ~~and~~ inside the city.

6. Bate's Case,(1606) 2 St.Tr.371,390(Fleming,C.B.).

7. See Tyagi, J., in Popular House v.Rajasthan,(1972) Tax L.R. 1996,1999.

8. For a brief history of the origin of the term see Burmah Shell Co. v. Belgaum Municipality, A.I.R.(1963) S.C.906,910-911.

The Constitution speaks of two types of octroi duties. The entry 89 of the Union List provides for "terminal tax on goods or passengers carried by railway, sea or air " and entry 52 of the State List provides for "taxes on the entry of goods into a local area for consumption, use or sale therein." The former tax is leviable by Union legislature and popularly know as octroi without refund,[9] and the latter tax is leviable by state legislatures. The terminal tax is leviable at a rail sea or air terminus and is "referable to services,(whether of carriage or otherwise) rendered or to be rendered by some rail or air transport organisation"[10] Terminal tax is levied at the end of a rail or air journey and not at the end of the transit of particular goods.[11] In the case of octroi duty the tax

9. See Ibid at 911. Terminal tax is leviable on goods exported as well as imported.The Constiution has conspicuously avoided the term octroi duty. A tax on export of goods levied by a local authority is not octroi, Arjun Singh v.Teek Chand, A.I.R.(1957) Raj.226,227.

10. Punjab Flour & General Mills v.Lahore Corpn.,A.I.R.(1947) F.C.14, 16(Spens,C.J.). It is respectfully submitted that reference to services by the learned Chief Justice is supported neither by history nor judicial authority on that point.

11. Empress Mills v. Municipal Committee, Wardha,A.I.R.(1958) S.C.341,349; See Achalpur Municipality v.Nandkishore, A.I.R. (1967) Bom,413,416 for the view that where the tax provided for both on export and import of goods it was a terminal tax and not octroi duty and hence invalid.A tax on motor vehicles plying inside is not octroi, Pandhurna Municipality v.R.P.Dube,A.I.R.(1969) M.P.1.

could be levied at the end of the journey of the goods and never in the case of goods in transit or on goods for passage[12] from one part to another part of the local area.[13] It is possible that the aqme goods may be subjected to a terminal tax as well as an astax octroi duty. Being an indirect tax, the local authorities prefer this to other direct taxes on the inhabit- ants and the levy interferes s much with internal trade also.[14] The octroi duty has now a days become a lucrative source of income to the local bodies.The relevant statutes of municipalities and local bodies provide for by laws being framed for levying octroi duty.[15] These bylaws should fix the octroi limits

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12. See Empress Mills v.Municipal Committe, Wardha,A.I.R.(1958) S.C.341; Loonkaran Parakh v.Madhya Pradesh,A.I.R.(1962) M.P.196,198(a fee of 12 p. for a transit pass also held invalid.).

13. Rajagopala Ayyangar, J., dissenting inDiamond Sugar Mills v. Uttar Pradesh,A.I.R.(1961) S.C.652,659 mentions three features of octroi duty.

14. Findlay Shirass, Science of Public Finane op.cit.,Vol.II p.671.

15. See Bagalkot City Municipality v.Bagalkot Cement Co.,A.I.R. (1963) S.C.771,774. It was held that where the original bye law fixed the limit as the Municipal District, it could be extended to new areas subsequently added to the Muni - cipality only through fresh publication.

within which the levy would be payable, the rates at which the levy is imposed[16] and the goods on which the levy is imposed.[17]

Regarding the fixation of octroi limits the local authority is not free to fix them at its own convenience. Entry 52 of the State List refers to a "local area" and this has been defined to mean an area administered by a local body in *Diamond Sugar Mills* v. *Uttar Pradesh*,[18] where a cess of 3 annas was imposed on every maund of sugar cane entering the premises of all vacuum pan sugar factories. The Allahabad High Court[19] had upheld the levy as an octroi and held that a "local area" included any limited or restricted area within the State and also the premises of a single factory following an earlier case,

16. *Singhai Tantilal* v. *Jabalpur Corpn*., A.I.R. (1960) M.P. 223, 226. Here the bye law provided that octroi would be levied on the cost price of goods and cost of carriage, though actually levied on the market value of goods. Held the levy was illegal.

17. See *Burmah Shell Co*. v. *Manmad Municipality*, A.I.R. (1958) Bom. 43. Where the rules as originally approved by the Government did not authorise the levy on goods brought in for sale. It was held that for amendment fresh approval was necessary.

18. A.I.R. (1961) S.C. 652.

19. *Murli Manohar* v. *Uttar Pradesh*, A.I.R. (1957) All. 159, 163.

Emperor v. *Munnalal*.[20] The Supreme Court of India rejected this view by majority. Rajagopala Ayyangar, J., in his dissenting opinion pointed out that the only question to be examined in the case was whether the levy was on cane sugar coming from outside the notified area. According to the learned judge the collection may be made at any convenient stage[21] and in the present case the collection at the factory premises was held not bad. The view that the collection may be effected at any convenient stage is supported by the decision in *Lord Krishna Sugar Mills v. Saharanpur Municipality*,[22] where the collection was made near the railway station and was approved by the Supreme Court.

An octroi duty is different from excise duty though both are leviable on the same commodity.[23] In *Bell* v. *Municipal Commrs. for the City of Madras*,[24] it was held that a license tax levied on timber brought into the city was a duty in the nature of octroi and the Provincial Government was liable to pay it.

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20. A.I.R.(1942)All.156,165. The case also arose under the U.P. Sugar Factories Control Act,1938.
21. See.A.I.R.(1961) S.C.652,660. Ayyangar, J., remanded the case to examine whether any cess was levied on cane sugar of inside origin.
22. A.I.R.(1966) S.C.1519,1521.
23. See *Ram Krishna* v.*Kamptee Municipality*,A.I.R.(1950),S.C.11 where it was held that the Excise and Salt Act,1944 did not prohibit the levy of octroi. See also *Lahore Municipality* v.*Daulat Ram*, A.I.R.(1942) F.C.14,17 for the view that no octroi was leviable on salt as under the Government of India Act, 1935 salt was within the exclusive federal comtrol.
24. (1902) 12 M.L.J.208,211,219 per Benson J., and Bhashyam Ayyangar, J.

The tax could be levied only in respect of goods bought for the purpose of consumption, sale or use and not for any other purpose.[25] The question whether goods brought within the local area to be sold for use or consumption outside the local area are liable to tax is not clear.[26] The term "use" in entry 52, List II has been given a very liberal meaning and it has been held that uncrushed salt brought from outside and crushed in a factory would amount to use within the local area attracting the liability to tax.[27]

An interesting problem which w has arisen with respect to the levy of octroi is whether the tax is a hindrance on the freedom of trade, commerce and intercourse guaranteed under Part XIII by the Constitution .Art.304(a) of the Constitution prohiits taxation on goods imported from other states except where similar taxes are imposed on goods produced or manufactured inside the state. In the case of octroi duty the unit of taxation is the area of a local authority[28] and not the whole state and tax is levied on all goods except those which

25. See Jothi Timber Mart.v.Corporation of Calicut,A.I.R.(1970) S.C.264,266. The Court held that such entry might be for other purposes apart from in the course of transit to other places.
26. See Hiralal Thakoralal Dalal v.Broach Municipality,(1975) 3S.C.C.876 where the matter was referred to a larger beach.
27. Jafarabad Municipality v.Kathiawar Industries,A.I.R.(1969) J&K.344.
28. Theoretically speaking, the state legislature may also levy this tax for revenue. But in view of Art.304(a) such a course seems to be impossible.

are inside the local area. So the tax falls both on goods of out of state origin and goods which are produced inside the particular state excluding the territory of the local authority. Art.304(a) extends the protection only to goods of out of state origin and since goods ~~of out exxax~~ produced within the state are also liable to pay the duty, the question of discrimination as such is not serious and the possible discrimination can arise only in the case of the goods originating in the particular local area which imposes the tax. Even then it is submitted that in view of Art.304(a) octroi duty cannot be levied on goods imported from outside the state into the local area though such duty may be levied on goods imported into the local area from other parts of the state.

The various high courts in India have examined the question[29] whether octroi duty is a compensatory tax or regulatory[30] measure within the meaning of Art.304(b) as held in Automobile Transport Ltd. v.Rajasthan.[31] Since entry 52 of the State List expressly authorises the levy, it has to be examined whether

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29. In Bangalore W.C.& S.Mills Co. v.Bangalore Corporation, A.I.R.(1962) S.C.562,565 the Supreme Court assumed that the levy of octroi was a direct hindrance on the freedom of commerce.
30. The earlier cases on the validity of octroi duty are not very helpful on this point.The Rajasthan High Court in Surajmal Baj v.Rajasthan,A.I.R.(1954) Raj.,260,262 took the viewthat it was violative of Part XIII of the Constitution and Andhra Pradesh High Court in Balaraju v. Hyderabad Municipality,A.I.R.(1960) A.P.234 took a contrary view. But in both these cases the levy was upheld as a presidential assent had been obtained.

31. A.I.R.(1962) S.C.1406.

the levy of octroi duty per se offends Art.301 and requires presidential assent for its validity. It is difficult to say that the levy of octroi does not affect commerce directly.[32] Some of the courts[33] have held that octroi was a tax of compensatory nature as the local authorities have to deal with various problems created by the entry of large quantities of goods daily. The High Court of Patna[34] has taken the view that an octroi cannot be termed a compensatory tax. It is submitted that octroi duty which is inherently a discriminatory tax on incoming goods should not be labelled as compensatory as that would deprive the courts the power to examine its reasonableness(for example, excessiveness of rate etc.) under Art.301.

Though octroi duty cannot be levied on goods in transit,[35] this being a source of revenue for the local authorities, the erection of octroi limits could be so arranged as to be a hindrance on trade or commerce. The leading case on this

32. But see Transport Corporation v. Muni.Corpn.,Indore,A.I.R. (1963) M.P.253, 255 for the view the levy is not a direct hindrance on commerce as it is levied on non-traders also.

33. Adilabad Municipality v.Mahado Seetha Ram,A.I.R.(1967) A.P. 363 , 366-367; Orissa Ceramic Industries v.Jharsuguda Municipality, A.I.R.(1963) Ori.171.172.

34. Patna Zila T.O.Assn. v.Bihar,A.I.R.(1963) Pat.16,20-21.

35. The courts have held that the procedure for claiming refund of octroi on subsequent export of goods is not imperative for a civil suit to lie. See Khurai Municipality v.Dhannalal Sethi,A.I.R.(1968) S.C.1458.

point is Lord Krishna Sugar Mills v. Saharanpur Municipality,[36] where the respondent Municipality errected its toll barrier[37] near the railway station situated within the municipal limits. The appellant mill was situated outside the municipal limits and large quantities of cloth were sent to different parts of the country through the railway station. As these goods were neither consumed nor sold inside the municipal limits they ought to be normally exempt from octroi duty. But duty was levied when entry into the local area was made at the toll barrier near the railway station. According to the Rules[38] where goods are only in transit and not imported a transit pass could be obtained. The question before the Suprme Court was whether the appellant was entitled to a transit pass. The Court by a majority[39] held that where goods are unloaded at the railway station, the party would not be entitled to a transit pass. The goods must leave the municipal area as soon as possible in the lorry on which they have entered and unless this is done the lorry would not be entitled to a transit pass.[40] Hidayatullah, J., in his dissenting note pointed out that

36. A.I.R.(1966) S.C.1519.
37. The duty was on goods and hence was octroi though termed toll.
38. R.8(a) "If the person in charge of a motor lorry laden with taxable goods declares in writing---that the goods he is importing into the limits of the Municipality are meant for immediate export from such limits without sorting and change of bulk, the moharrir shall issue a transit pass..... who shall present the same...at the barrier of export within half an hour from the time of issue of the transit pass".
39. Gajendragadkar, C .J.,Wanchoo, Ramaswami and Raju, JJ. Hidayatullah, J., dissented.
40. See A.I.R.(1966) S.C.1519,1521.

goods in transit could not be taxed and that under the rules the goods if brought back from the station yard would be liable to a similar tax again.[41]

The majority view, it is submitted, is difficult to be reconciled with the view expressed in Empress Mills v. Municipal Committee, Wardah[42] that refund of tax on goods in transit did not depend on provisions for transit pass, refund etc. It would be putting a strained construction to say that the Empress Mills case is not applicable where goods are sent not in the same vehicle as happened in the Lord Krishna Sugar Mills case as part of the journey was in lorry and the rest in train. It is submitted, that the decision need be understood as only one interpreting a particular rule of Rules on Tax Tolls, 1949.

The Report of the Road Transport Taxation Enquiry Committee on Octroi and Other Check Posts has pointed out the adverse effects of this duty on inter-state commerce. Income

41. Ibid at 1523. Even a toll could not be collected twice for the same privilege, see Hardwar Municipality v. Raghubir Singh, A.I.R.(1958) All.430,432.

42. A.I.R.(1958) S.C.341. See also Khurai Municipality v. Dhannalal Sethi, A.I.R.(1968) S.C.1458,1461.

from octroi is the chief revenue in the case of most of local authorities because thereby they can impose very little direct taxation on the inhabitants and this is also a lucrative source for patronage and corruption.[43] Though goods in transit are exempt from octroi, such goods have to pay the tax when they enter the local limits and can claim refund only at the other end when they leave the local area. This involves considerable delay in the traffic of goods and it can be only imagined what will happen if every local authority imposes octroi on goods in transit and insists upon claiming refund later.[44]

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43. See Report, (1967) P.6

44. The Report gives an instance of a vehicle being detained for more than 68 hours to travel a distince of 500 miles. See Report,(1967) p.11.

CHAPTER X.

TYPES OF TAXES (CONTD.)

TAXES ON MOTOR VEHICLES AND TRANSPORTATION.

Taxes on Motor Vehicles and Passengers and Goods Carried by Road or inland Water ways.

The increase in the number of motor vehicles engaged in road traffic has paved the way for taxation of such vehicles for the purposes of revenue. Entry 57 of List II of the Seventh Schedule to the Constitution provides for "Taxes on vehicles, whether mechanically propelled or not suitable for use on roads including tram cars subject to the provisions of entry 35 of List III[1]." It has been held[2] that entry 57 of the State List authorises the state legislatures to fix the rates of tax and entry 35 of List III empowers them to prescribe the rules for guidance in the matter of taxation subject to the overriding power of Union Parliament. Under entry 57 of the State List it appears that to attract the taxing power of the state, irrespective of actual use of such vehicle on public roads, the vehicles need only be suitable for use on roads. In <u>Bolani Ores</u> v. <u>Orissa</u>,[3] the issue was whether certain vehicles

1. Entry 35 of List III reads"Mechanically propelled vehicles including the principles on which taxes on such vehicles are to be levied".

2. See <u>Assam</u> v. <u>Labanya Probha Debi</u>, A.I.R.(1967) -S.C.1575,1577.

3. A.I.R.(1975) S.C.17.

like dumpers and rockers are liable to tax under the Motor vehicles Taxation Acts of Orissa and Mysore when they were exclusively used within the premises of private parties. It was clear that these vehicles were capable of use in public roads. However, the Court held[4] that the legislation was a regulatory measure imposing compensatory tax for the purpose of raising revenue to meet the expenditure for making roads, maintaining them and for facilitating the movement and regulation of traffic. It was also held that entry 57 of the StateList was subject to the limitation that the power of taxation there under could not exceed the compensatory nature which must have some nexus with the vehicles using the roads. So tax was held to be not payable by vehicles which do not use public roads at all.[5] It is submitted, that the reference to compensatory character of tax laws was unwarranted as that doctrine is applicable only when a tax is challenged as a hindrance to the freedom of trade or commerce under Art.301 of the Constitution.[6] In such cases, where the challenge is that a particular tax infringed the freedom under Art.301, the enquiry begins whether it can be sustained as a compensatory tax. To say

4. Ibid at 28.
5. To support the reasoning it was pointed outthat the Acts contain provision for refund of tax when any vehicle is declared as not using the roads for a particular time . Such a provision is applicable to vehicles which are incapable of use owing to repairs etc., and hence not"suitable" within the meaning of entry 57, List II.
6. See Automobile Transport Ltd. v.Rajasthan,A.I.R.(1962) S.C. 1406,1425.

that a tax under entry 57 of the State List could only be such a tax is to put unnecessary restrictions on the taxing power of the legislature.[7]

It is well settled that the tax may be with[8] reference to the laden weight of vehicles or to passengers carried by them.

The tax on passengers and goods carried by road or inland waterways is provided for by entry 56, of the State List of the Seventh Schedule to the Constitution of India. Under the Government of India Act,1935 the relevant entry provided only for duties on passengers and goods carried on inland waterways and not by road.[9] The tax could be calculated on the basis of fares and freights received by the operator and the adoption of such a basis would not make it a tax on income.[10] It is not on all goods and passengers but only on goods and passengers carried by road or inland waterways that the tax could be imposed. The legislature could provide for collection of tax from any person who is intimately or directly connected or has a nexus with such goods or passengers. Hence

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7. The other part of the judgement that the two relevant statutes did not in fact contemplate such taxation is beside the point.
8. Swarnavar Nashar v.Mysore, A.I.R.(1963) Mys.49.
9. See Hardwar Municipality v.Raghubir Singh, A.I.R.(1966) S.C. 1502,1505 for the effect of such a limitation.
10. Sainik Motors v.Rajasthan,A.I.R.(1961) S.C.1480,1484; E.A. Thomman v. R.T.O.,Ernakulam,A.I.R.(1969) Ker.130,134.

it has been held that there was no infirmity in providing for collection of tax from owners of vehicles[11] or from producers of goods which were later so carried.[12] It has also been held that state legislatures could tax vehicles which incidentally have to pass through a portion of the state territory.[13] In such cases even if tax is imposed on the charge for the full journey, it is only a mode of assessment and has no relation to the competency of the legislature.[14]

Toll

The toll tax is in reality a tribute or custom[15] paid for a privilege, generally for a passage over or for using a bridge, road, ferry and sometimes for occupation of market, port, anchorage etc. In England, tolls are mainly of two types, toll-through, which is levied by town authorities for passing through its roads, bridges, ferries, and toll-traverse, which is levied by private persons for passing through their land. The Constitution of India by entry 59, List II, to the Seventh Schedule provides for the levy of toll.

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11. See Rai Ram Krishna v. Bihar, A.I.R.(1963) S.C.1667,1672.
12. See Khyerbari Tea Co. v. Assam, A.I.R.(1964) S.C.1925,935, But on facts it was held that those producers themselves had carried tea from the gardens to the port of Calcutta. Ibid. at 936.
13. See Automobile Transport v. Rajasthan, A.I.R.(1962) S.C.1046.
14. See Surrendra Tr.& Eng.Co. v. Punjab, A.I.R.(1954) Punj.264.
15. Toll has been defined as " a sum of money for the use of something generally applied to the consideration which is paid for the use of a road, bridge or the like of a public nature". Cooley, The Law Of Taxation op.cit.,p.77. It has been stated that tax is a demand of sovereignty; a toll is a demand of proprietorship. 71 Am.Jur.2d.p.351.

The basis of toll tax is that the person who pays it enjoys a privilege of using a road. So generally, it is also in his interest to pay the toll and have thefacility. As such it could be seen that toll is generally paid for some privilege obtained by the payer. In Hindustan Vanaspathi Mfg. Co. v. Ghaziabad Municipality.[16] Srivastava, J., on a difference of opinion[17] has between Mootham,C.J., and Raghubar Dayal, J.,observed that where a statute authorised the levy of a toll,without specifying that it had to be levied in respect of a particular service rendered or benefit provided, it could not be said that for every toll sought to be levied some specific benefit or advantage must be provided. In the instant case the appellant company obtained raw materials by rail brought into its premises through a direct railway line. The wagons and the land through which it ran belonged to the railway. If the municipality wanted to levy a duty on goods brought within its jurisdiction the proper tax would have been an octroi duty and not a toll tax, because it is commonly understood that a toll could be levied only on vehicles and not on goods carried by it.

16. A.I.R.(1962) All.25,41.

17. Mootham,C.J., of the view that there should be some consideration and Dayal,J., of the view that it was not necessary in the case of a statutory levy.

S.128 of U.P.Municipalities Act,1916 also authorised the levy of "toll on vehicles and other conveyances and animals". There is also high authority for the proposition that a toll under that section is leviable only on vehicles and not on passengers.[18] It is submitted that the decision is wrong.[19] Moreover whatever be the position in England, in India there can be no tax without a statutory backing and the distinction attempted to be made on that footing by the learned Judge is clearly unwarranted. If persons who do not use a bridge is made to pay toll, the nature of the tax is certainly altered. Generally tolls have consideration in return as when levied for use of roads.[20]

A toll is different from octroi duty in as much as toll is levied on vehicles and octroi is levied on goods entering the limits of the local authority.[21] The toll is different

18.See Nainital Municipality v.Birj Mohan Chandra,A.I.R.(1971) S.C.439,440.

19.The learned judge had observed that the levy was "in consideration of all the conveniences, advantages and amenities which the appellant is enjoying on account of having its factory within the municipal limits" A.I.R.(1962) All.25,42. It is submitted that, that would not have been an adequate consideration to uphold even a fee.

20.See P.L.and Lime Stone Co. v.Cantt.Bd.,Dehradun,A.I.R.(1967) All.15, 17; Surendra Kumar v.Himachal Pradesh,(1972) Tax L.R.2165,2171.

21.Bell v.Municipal Commissioners, Madras,(1902) M.L.J.208,211 220.See also Surat Municipality v.Maneklalcharm,(1920)12 Bom. L.R.1104. However in Mt.Bayebi v.District Council, Nagpur, A.I.R.(1936) Nag.258 the ground rent in respect of a market for cattle sale was held to be a toll. The decision may be distinguished as the matter involved was not the nature of the tax, but as to who had authority to collect the rent, the malguzar of the area or the respondent Council.

from a tax on motor vehicles inasmuch as the toll can be levied on such vehicles for using certain facilities or privileges only. In Hardwar Municipality v. Raghubir Singh,[22] the Supreme Court considered the question whether a toll could be levied on vehicles entering the city limits or leaving such limits. Though the constitutional issue was left open by the Court, it seems that there is nothing wrong in imposing the toll at either of these points of time in accordance with the canon of convenience of collection of tax.

The toll being a tax on traffic, the question arises as to whether it is a restriction on freedom of trade, commerce and intercourse guaranteed by Part XIII of the Constitution.The toll has been held to be a compensatory tax within the meaning of Art.304(1)[23]. This view is understandable as toll is levied in return for some privilege enjoyed by the

22.A.I.R.(1966) S.C.1502,1506. If the vehicle is already inside the municipal area, no ~~xx~~ toll can be levied. Manipuri Municipality v. Kanhaiyalal, A.I.R.(1960) S.C.184.

23.Jubilee Highway Tr. v. Punjab, A.I.R.(1964) Punj.506,507.

payer.[24] It has been observed that[25] " toll is no hindrance to any body's freedom, so long as it remains reasonable, but it could, of course, be converted into a hindrance to the freedom of trade. If the bridge authority really wanted to hamper anybody's trade, it could easily raise the amount of the toll to an amount which would be prohibitive or deterrent". It is submitted, that where a state levies both motor vehicles tax and tax on passengers and goods, an additional imposition of toll at particular points would be burdensome and also non compensatory.[26]

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24. See Girdhari Lal v. Jammu & Kashmir, A.I.R.(1969) J.& K. 113;120; Mohammed Ibrahim v. Uttar Pradesh, A.I.R.(1967)All. 24.

25. See Fullagar, J., in McCarter v. Brodie,(1950) 80 C.L.R.432,497.

26. S.21 of Rajasthan Motor Vehicles Taxation Act,1951 prohibited the levy of toll or any other ta on motor vehicles. See Narain v. Cant. Board, Nasirbad, A.I.R. (1963) Raj.190. See Jethmal v. Heeralal, A.I.R.(1958) Raj.48 where terminal taxes on motor vehicles imposed by local authorities were struck down.

CHAPTER XI

TYPES OF TAXES(CONTD.)

TAX ON ADVERTISEMENTS, LUXURIES ETC.

Tax on Advertisements

The entry 55 of the State List confers power on the state legislatures to levy "taxes on advertisements other than advertisements published in newspapers". The tax on advertisements is generally levied and collected by local authorities and is different from a tax on profession or calling.[1] The difficulty in differentiation may arise in a case where the tax is levied on a person who is engaged in the business of advertisement. In such cases the distinction has to be maintained between a tax on each and every advertisement and a tax on the person for having engaged in the business of publicity. The power to tax advertisements published in newspapers is with Parliament under entry 92 of the Union List.

Taxes on Luxuries, Entertainments, Amusements, Betting and Gambling.

The entry 62 of the State List confers the power on state legislatures to impose" Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling". These taxes are discussed in the following pages.

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1. Ismail & Co. v. Kerala, A.I.R.(1965) Ker.237.

Tax on Luxuries.

The tax on luxury is imposed either to restrict the expenditure of money in certain directions or to tax the rich or that part of the expenditure of all classes that is regarded as a superfluity or as socially undesirable.[2] There is some confusion as to whether the tax is on certain articles or goods constituting luxuries[3] or it is on money spent on any luxury. It is submitted that the power to tax under entry 62 of the State List[4] need not be restricted to the former view. In accordance with the latter view, a higher rate of tax on air conditioned rooms in a hotel has been held to be a luxury tax.[5]

In A.B.Abdul Kadir, v. Kerala,[6] the Supreme Court considered the scope and ambit of the tax on luxuries with reference to the question whether tobacco was an article of luxury.[7] It was held that the fact that the use of an article was popular among the poor section of the population would not detract from its description or nature of being an article of luxury. An expenditure on something which was in excess of

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2. M.S.Menon, J., in T.K .Abraham v. Travancore-Cochin, A.I.R. (1958) Ker.129,134.
3. Ibid.
4. In Prince Azam Jha v. Expenditure Tax Officer, A.I.R.(1972) S.C.2319,2324 it was held that the Expenditure Tax Act,1972 did not fall within the legislative entry 62 of the State List.
5. Spences Hotel v. West Bengal,(1975) Tax L.R.1890(Cal.).
6. A.I.R.(1976) S.C.182.
7. Ibid at 180. The Court pointed out that the concept of luxury was not static and that the luxuries of yesterday could well become necessities of today.

what was required for economic and personal well being was held to be an expenditure on luxury and liable to taxation. This decision apparently seems to take the view that the tax is on articles of luxury and not on the money spent on such luxuries as the decision was concerned with a retrospective levy of license fee for storing tobacco. However, such impositions will increase the price of tobacco and ultimately it ~~necessary~~ necessarily falls on the consumer as a tax on the money spent by him on luxuries and the marginal consumer may change his habit of using tobacco.

(ii) Tax on Entertainments and Amusements.

The tax on entertainments and amusements includes the tax on cinematograph exhibitions, dramatic performances, horse races, games, etc. The tax is generally imposed on the person who conducts the entertainment and as such is different from a profession or business tax on him for conducting such a business.[8] Since the tax is on entertainments the tax may be on the entertainer or the person entertained or on both.[9] It also

8. Western India Theatres v. Contonment Board, A.I.R. (1959) S.C. 582, 585.
9. Municipal Council v. Mahadeva Iyer, (1970) K.L.T. 577, 580. The tax may be on the net collection (price of the ticket excluding the tax) or on the gross collection (including the tax collected separately) J.K. Kapur v. Gujarat, A.I.R. (1974) S.C. 1996; Liberty Talkies v. Gujarat, (1971) 3 S.C.R. 398.

follows that such entertainment need not be conducted with money or other consideration for admission.[10]

(iii) Tax on Betting and Gambling.

The tax on betting and gambling includes betting tax on horse races and tax on lotteries. The tax has generally a regulatory motive as in the case of a tax on luxury, to prevent the poor sections of the people from indulging in such activities and usually a heavy rate of tax is levied. The tax may be levied on the promoter, race club or book maker as they can pass over the tax to persons who participate in such betting and gambling.[11] The essence of a lottery is the distribution of prizes among subscribers by lot or chance.[12] Hence the tax is not legally leviable on activities which are not lotteries.[13]

(iv) Tax on Electricity.

The tax on sale or consumption of electricity can be levied by the state legislatures by virtue of entry 53 of the State List. Since the tax can be imposed either on sale or consumption of electricity, a producer who consumes the

10. G.R.Talkies v.Andhra Pradesh,(1971) 2 An. W.R.113,117. But if the payment made is only an advance payment for price of goods purchased later at a fair and not the price of admission, it has been held that no tax is payable. Calico Mills Ltd. v.Madhya Pradesh,A.I.R.(1961) M.P.257.
11. Bombay v.R.M.D.C.,A.I.R.(1957) S.C.699,710-711.
12. Mansell v.Beck,(1956) 95 C.L.R.550,565(Dixon,C.J.)
13. See B.& G.Exchange Ltd. v.Punjab, A.I.R.(1961) S.C.268. A tax on forward contracts was held to be bad as forward contracts were not wagering contracts.

energy himself will not be exempt from the tax.[14] If in the process of consumption the energy is lost in the course of transmission, no tax is payable for that part which is lost.[15]

(v) Stamp duties.

The stamp duties are taxes imposed on documents and deeds executed to evidence legal transactions and documents filed in courts of law and are of two types, judicial and nonjudicial. The nomenclature' stamp duty' is derived from the particular mode of recovery of this type of tax by means of the sale of stamps, impressed or adhesive, by which the tax is received in advance. The tax is on the instrument and not on the transaction and not even on the property which it creates or transfers and may be at a fixed rate or ad valorem. The evasion of stamp duty is attempted to be prevented by rendering unstamped or insufficiently stamped documents inadmissible in evidence in courts of law.

The Constitution distributes the power to impose stamp duty between the Union and state legislatures. The power to impose stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies

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14. J.C.Mills v.Madhya Pradesh,A.I.R.(1963) S.C.414.
15. Mysore v.West Coast Paper Mills Ltd., A.I.R.(1975) S.C.5.

of insurance, transfer of shares, debentures, proxies and receipts is with the Parliament by virtue of entry 91 of the Union List. The power to impose stamp duty in respect of other documents not specified in entry 91 of the Union List is with the state legislatures by virtue of entry 63 of the State List. This power of the state legislatures has been held[16] to include the power to impose stamp duty on the certificate of enrolment of persons who practise as advocates.

The judicial stamp duty known as court fees is in the nature of fees for services rendered,[17] and is payable for the institution of suits and for filing documents in civil courts even though such measures profess to discourage superfluous litigation. The power to prescribe the court fees payable in the Supreme Court of India is with Union Parliament under entry 77 of the Union List and the power to prescribe court fees in respect of all other courts is with the state legislatures under entry 3 of the State List.

(vi) Tax on Animals and Boats.

The entry 58 of the State List confers the power to impose "taxes on animals and boats" on the state legislatures. Though taxes may be levied on animals like dogs etc., the modern tendency is to levy a nominal amount for the purpose of licensing and regulation.

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16. Bar Council, Uttar Pradesh v. Uttar Pradesh, A.I.R.(1973)S.C.231.
17. Government of Madras v.Zenith Lamps, A.I.R.(1973) S.C.724.

(vii) Capitation Tax

The capitation or poll tax is a tax on the poll[18] without reference to property, business or other circumstances.[19] It is imposed numerically upon persons without considering their capacity to pay it and in that sense satisfies the test of crude equality in taxation. The poll tax may be treated as a tax on the right to vote in a democratic country, but in view of Art.326 of the Constitution the payment of tax cannot be made a condition precedent for the exercise of franchise.

(viii) Royalty.

The term royalty is equivalent of "regalitates".[20] generally speaking, royalty is not a compulsory exaction like[21] a tax or a fee. The basis of payment is contractual and the payment is in consideration of the enjoyment or use of some property or right belonging to the state. As such it partakes the character of rent or premium and it is highly doubtful whether the constitutional provisions relating to taxation would be applicable to it.

18. The entry 61 of the State List gives power to the State legislatures to impose capitation taxes.
19. Cooley, The Law of Taxation opt.cit.,pp.3497-3498.
20. "Jura regalia" and "Jura regia" see Dyke v.Walford,(1848) 5 Moo.P.C.434. In its ordinary-general meaning the terms include escheat also A.G.for Ontario v.Mercer(1883) 8A.C. 767,779.
21. Cf.H.R.S.Murthy v.Collector of Chittoor,A.I.R.(1965) S.C. 177,180. Normally the term cannotes payments made for minerals or materials won from the land. In mining leases the term royalty has a special meaning "signifying that part of the reddendum which is variable,and depends upon the quantity of minerals gotten" Earl of Selbourne, L.C., in A.G. for Ontario v.Mercer,(1883) 8 A.C.767,777.

In Suraidin Laxmanlal v.Madhya Pradesh.[22] a royalty was imposed on all liquor contractors for the privileges of removing fuel from the protected forests. The petitioner's contention was that he was not availing himself of such a privilege and hence he could not be held liable for the amount. The Court held that the two features of royalty were payment in proportion to the quantity removed and basis of payment was held to be agreement.[23] The Court held that in the present case the exaction would amount to a tax and Art.265 was attracted.In Shanti Swaroop Sharma v. Punjab[24], it was held that it was more as akin to rent or compensation payable to an owner by the occupier or lessee of land for the use or exploitation of resources contained in it. It was also laid down that merely because the provision with regard to royalty was made by statute or that a uniform rate was prescribed throughout the state would not make it a compulsory exaction in the nature of a tax or impost.

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22. A.I.R.(1960) M.P.129,130. In Veda Vyascharya v.Mysore,(1962) 13 S.T.C.465 (Mys.).it was held that royalty was not excise duty.
23. See Sethi Marble Stone Industries v.Rajasthan,A.I.R.(1958) Raj.140,142. Royalty was defined as a payment made to an owner for the right to exploit his properties in Bherulal v. Rajasthan,A.I.R.(1956) Raj.161,162. See royalties for patents and copy rights.
24. A.I.R.(1969) Punj.79, 90.A case under Punjab Minor Mineral Concession Rules,1964.

A contrary view was taken by Patna High Court in Laddu Mal v. Bihar [25], where it was held that royalty was a tax and not a fee. It is respectfully submitted, that the view taken by the Court is wrong. The Court really found it difficult to sustain the levy as the Mines and Minerals (Regulation and Development) Act, 1957 did not provide for any levy by subordinate legislation. This difficulty was overcome by the Court by holding that conditions of rent and royalty were integral parts of a lease [26]. It is submitted that all this difficulty could have been avoided if the states had cared to legislate under entry 50 of List II which reads "Taxes on mineral rights subject to any limitation imposed by Parliament by law relating to mineral development". Since the power to tax mineral rights vests with the state, the power exercised by Parliament in collecting royalty on minerals [27] could be valid if it is not a tax. The states could as well tax minerals apart from minor minerals as there is no express prohibition to that effect under the Central Act LXVII of 1957.

25. A.I.R.(1965) Pat.491,494.
26. See Ibid at 496.
27. The distinction made in Mines and Minerals (Regulation and Development) Act, 1957 is between minerals and minor minerals, the states having jurisdiction over the latter. See Baiju Nath v. Bihar, A.I.R.(1968) Pat.50,56.

ix) <u>Cess</u>

Cess is a tax and is used when the levy is for some special administrative purpose, for example, health cess, education cess etc.[28] That is to say, the receipts of a particular tax are earmarked for some particular purpose and it does not matter whether it goes to the general revenue of the state or not.[29] This is the only similarity between the cess and a fee and no question of quid pro quo between collections and services arises in the case of a cess.[30]

In every case of levy of a cess the enquiry is as to whether the levy is authorised under a particular tax entry. When levied as an increment to an existing tax, its validity ought to be judged in the same way as the validity of the tax to which it is an increment.[31] The law is well settled

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28. See Hidayatullah, J., in Shinde Brothers v. Deputy Commr., Raichur, A.I.R.(1967) S.C.1512,1525; Shanmugha Oil Mill v. Coimbatore Market Committee, A.I.R.(1960) Mad.160,164.

29. Jadeja Habubha v. Bombay, A.I.R.(1959) Bom.43,46.

30. See Hingir-Rampur Coal Co. v. Orissa, A.I.R.(1961) S.C.459 the cess was held to be a fee in reality. In J.R.G.Mfg. Assn. v. Union of India, A.I.R.(1970) S.C.1589 the rubber cess was held to be an excise duty.

31. Shinde Brothers v. Deputy Commr., Raichur, A.I.R.(1967) S.C. 1512,1525; In Jadeja Habhubha v. Bombay, A.I.R.(1959) Bom. 43,46 the cess was held to be a tax on land under entry 49, List II. See also Ramchand v. Malkapur Municipality, A.I.R.(1970) Bom.154,157.

on these points by two recent pronouncements of the Supreme Court. In <u>Diamond Sugar Mills</u> v.<u>Uttar Pradesh,</u>[32] the sugar cess imposed under U.P.Sugar Cane Cess Act,1956 was held to be an octroi duty under entry 52 of the State List and in <u>Shinde Brothers</u> v.<u>Deputy Commr.,Raichur</u>,[33] the health cess collected from liquor contractors was held to be only a surcharge on tax.[34] On this view it has been held that a law imposing a cess need not provide for appeals from assessment orders etc., as the provisions in the other statute, to which incorporation by way of reference is made, will apply.

(ix) <u>Surcharge</u>

The surcharge is not an independent tax but is only an enhancement of a particular tax[35] and is an additional

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32.A.I.R.(1961) S.C.652,658

33.A.I.R.(1967) S.C.1512,1519; In <u>Prasad Rao</u> v.<u>S.S.for India</u>, (1917) I.L.R.40 Mad.886,896. The water cess under Irrigation Cess Act,1865, was held to be in the nature of land tax. In <u>Virudhunagar Malai Pettai</u> v. <u>Madras</u>,A.I.R.(1964) Mad.458 the cess under Mad.Agri.Produce Markets Act was held to be a sales tax.

34.So if the original levy is bad, the surcharge also becomes illegal.<u>Municipal Council,Vizianagaram</u> v. <u>Shah Bibi Saheba</u>, A.I.R.(1968)A.P.194,198.

35.<u>Ahmedabad Mfg.& Calico Printing Co.</u> v.<u>Gujarat</u>,A.I.R.(1967) S.C.1916,1920.

or extra charge.[36] The basis of the power to levy surcharge is the particular tax entry of the legislative list of the Constitution.[37] It has been held that surcharge is not a tax on tax.[38] The surcharge in this respect is similar to a cess but differs from a cess as surcharge is not levied for any particular purpose.

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36. C.I.T. v. K.Srinivasan, A.I.R.(1972) S.C.491,495.

37. Art.271 is not the basis of the power to levy surcharge. See Mathew, J., in Ernakulam Radio Co., v. Kerala,(1966) K.L.T.809,812. The contrary view expressed in Vedvyas Chawla v. I.T.O., Allahabad, A.I.R.(1965) All.37 is not correct.

38. S.Koder v. Kerala, A.I.R.(1974) S.C.2272,2274; Vishwesha Thirtha Swamiar v.Mysore, A.I.R.(1971) S.C.2377,2379; Anantha Kondayya Setty v.Kurnool Municipality,A.I.R.(1963) A.P.379.

PART THREE

FUNDAMENTAL RIGHTS AND THE POWER OF TAXATION.

CHAPTER XII

EQUALITY BEFORE LAW AND THE POWER OF TAXATION

Introductory

The Constitution of India has followed the example of the United States of America in incorporating certain fundamental rights enforceable by courts of law. Part III of the Constitution of India which deals with the fundamental rights consists of twenty four articles, Article 12 to Article 35 arranged under eight sub-headings.[1] Article 32 and Article 226 of the Constitution specifically authorise the Supreme Court and the high courts respectively to enforce these fundamental rights. The fundamental rights are conferred mostly in general terms with certain exceptions. As such there is little mention of the taxing power in Part III of the Constitution and the only provisions which expressly deal with taxation power are Art.27[2] and Art.31(5)(b)(i)[3].

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1. (i) General(Arts.12 and 13), (ii) Right to Equality (Arts.14 to 18), (iii) Right to Freedom (Arts.19-22), (iv) Right against Exploitation (Arts.23 and 24),(v) Righto Freedom of Religion(Arts.25-28),(vi)Cultural and Educational Rights(Arts.29 and 30),(vii) Right to Property (Art.31) and (viii) Right to Constitutional Remedies(Arts.32-35).

2. The restriction imposed by Art.27 has been discussed in the introductory chapter.

3. Art.31(5)(b)(i) reads:"Nothing in clause(2) shall affect... (b) the provisions of any law which the State may hereafter make (i) for the purpose of imposing or levying any tax or penalty, or".

Taxation laws are generally challenged under Part III of the Constitution invoking Art.14 as offending the rule of equality before law or under Art.19 as being an unreasonable restriction on the right to hold property or on the right to carry on any trade, business or profession.[4] Regarding the possible challenge under Art.31 as deprivation of property without the authority of a valid law, the validity has to be determined under Art.19(5) .Hence no separate attempt is made to discuss the operation of Art.31 on the power of taxation. The problem whether the fundamental rights can be retrospectively affected by taxing power is, as seen already, dealt with along with the general question of retrospectivity and taxing power in Part I, Chapter 2. The present chapter is devoted to study the impact of the provisions of the right to equality on the taxing power of the state.

Equality Beofe Law and the Power of Taxation.

Article 14 of the Constitution of India states that "State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India". Article 14 combines the english doctrine of the rule of law and the equal protection clause of the XIV Amendment to the American Federal Constitution which enjoins that no state shall deny to any person within its jurisdiction

4. Art.31(2) has no application to taxation laws in view of Art.31(5)(b)(i)."Art.31(2) would be in applicable to a taxing statute because the taxing statute does not purport to acquire or requisition any property". Gajendragadkar, J., in Jagannath Baksh Singh v. Uttar Pradesh, A.I.R.(1962) S.C. 1563,1571.

the equal protection of the laws.[5] Whether these two concepts have the same meaning and content or whether they are different in scope is difficult to answer. One a view is that the concept of "equality before law" aims at the legislature and the concept of "equal protection of laws" aims at the executive. That is to say, that the former concept prohibits legislative discrimination while the latter concept prohibits executive discrimination. It is submitted that this view has not much to commend itself as in U.S.A., the concept" equal protection of laws" is generally understood as a prohibition against discrimination by all the three organs of the state- the legislature, the executive and the judiciary.[6] Subba Rao, J., has observed[7] that the difference between the two concepts was that equality before laws was a negative concept and the equal protection of laws was a positive concept. It seems that any attempt to find out separate spheres for both these concepts to act would be of only academic interest. The Supreme Court of India is in

5. Das, C.J., in Basheshar Nath v. C.I.T.,A.I.R.(1959) S.C. 149,158. According to Sastri,C.J., in West Bengal v. Anwar Ali,A.I.R.(1952) S.C.75,79 the concept of equality before law is adopted from the Irish Constitution.
6. See Shelley v. Km Kraemer, (1948) 334 U.S.1,14.
7. Uttar Pradesh v.Deoman Upadhyaya,A.I.R.(1960) S.C.1125,1134.

interpretting Article 14 of the Constitution of India has adopted the doctrine of classification developed by the United States Supreme Court.[8] In U.S.A. the XIV Amendment was brought about for protection of the negro race and is available only against the state governments and not against the Federal Government.[9] The present study is also to assess the wisdom in importing the American concept of equal protection of laws into Art.14 by our Courts.[10]

The tests adopted for determining whether a classification is reasonable or not are"(1) that the classification must be founded on an intelligible differentia which distinguishes persons or things that are grouped together from others left out of the group; and

(2) that that the differentia must have a rational relation to the object sought to be achieved by statute in

8. See R.K.Dalmia v.Tendolkar, J., A.I.R.(1958) S.C.538,547; Budhan Chowdhury v. Bihar,A.I.R.(1955) S.C.191,193. For an interesting criticism by Bose, J. See Bidi Supply Co v. Union of India, A.I.R.(1956) S.C.479,484 "Despite the constant endeavour of judges to define the limits of this law, I am unable to deduce any clear cut principle from the oft-repeated formula of classification".
9. The due process clause of V Amendment is made use of against Federal Government.
10. For early criticism of such attitude see West Bengal v. Anwar Ali, A.I.R.(1952) S.C.75.Fazl Ali, J., at 83; Bose J., at 102.S. Lachhman Das v. Punjab, A.I.R.(1963) S.C.222,240.(Subba Rao,J.)

question."[11]

It has been held that Art.14 forbids" class legislation"[12] and does not forbid reasonable classification as the purpose of classification is to avoid or correct inequalities and not to create them.[13] By the term"class legislation" perhaps the courts intend to mean only legislation based on an unreasonable classification as it is Article 15 that forbids class legislation. Though in reality men are not equal, in the eye of law from the moment of birth onwards mankind is a society of equals.[14] But an intransigent adherence to standard of equality is not possible and discrimination with respect to things that are different is permitted.[15]

Tht two tests used to determine permissible classification are comulative. The first test that the classification should be based on an intelligible defferentia

11. Budhan Chowdhury v. Bihar, A.I.R.(1955) S.C.191,193. A possible third rule that the object ought to be legal also may be treated as an independent form of challenge. See Bose, J, in Bidi Supply Co. v. Union of India, A.I.R.(1956) S.C. 479,486.
12. Das, J., in Budhan Chowdhury v. Bihar, A.I .R.(1955) S.C.191 193; Chitra Ghosh v. Union of India, A.I.R.(1970) S.C.35,38 (Grover,J.).
13. The statement reminds one that made by Harlan, J.,(dissenting in Plessy v. Ferguson,(1896) 163 U.S.537,559 that "Our Constitution is colour blind and neither knows nor tolerates classes among citizens".
14. See Benjamin, N.Cardozo, Law And Literature(New York,1931), P.110.
15. "It was a wise man who said that there is no greater inequality than the equal treatment of unequals" Frankfurter, J., in Dennis v. United States,(1950) 339 U.S.162,184. "Procrustean cruelty cannot be equated with guarantee of constitutional equality" Krishna Iyer,J.,in Murthy MatchWorks v. Asst. Collector, A.I.R.(1974) S.C.497,504.

means that the basis adopted for classification should not be vague. This test as such is not important as many classifications could easily pass this test. The second test that the differentia employed ought to have a rational nexus to the object sought to be achieved is the important part, because many classifications can be over inclusive or under inclusive.

The underlying purpose in subjecting the taxing power to Article 14 ~~of~~ is that the state should try its best to distribute the burden of taxation evenly and equitably. Generally, the courts allow a wide latitude to legislative classifications in fiscal statutes, the presumption being always in favour of its validity and the burden being on the person, who challenges, to show that such classification was unreasonable. The reason for this attitude is that where there is more than one basis of classification and the legislature selects one of them, the court would not be justified in interfering on the ground that the legislature ought to have adopted the other basis which was more reasonable ~~ought~~ according to the court. Hence the courts interfere only in cases where the classification is capricious,[16] fanciful,[17]

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16. Ameerunissa Begum v. Mahaboob Begum, A.I.R.(1953) S.C.91 (a private dispute settled by legislation).
17. Kameshwar Singh v. Bihar, A.I.R.(1951) Pat.91,111(classification between rich and poor landlords for awarding compensation).

arbitrary or clearly unjust.[18] [19] In determining the reasonableness of a tax law under Art.14 the inquiry is still different. In Ravi Varma Rajah, v. Union of India,[20] it was observed"Again the tax laws are aimed at dealing with complex problems of infinite variety necessitating adjustment of several disparate elements. The Courts accordingly admit, subject to adherence to the fundamental principles of the doctrine of equality, a larger play to legislative discretion in the matter of classification. The power to classify may be exercised so as to adjust the system of taxation in all proper and reasonable ways...". Thus the legislature is free to select objects and tax them and there is no violation of the equal protection clause merely because other objects could have been, but are not, taxed by the legislature.[21] Such attitude of the Court is

18. Rama Prasad v. Bihar, A.I.R.(1953) S.C.215. An arbitrary selection of a person on whom land was settled by the court of wards to declare such settlement invalid.
19. Dinnapati S.Reddi. v. Chancellor, Osmania University, A.I.R. (1967) S.C.1305, 1314(a statutory provision which restricted the term of office of existing Vice Chancellor alone to 90 days while the subsequent Vice-Chancellors could hold the post for 2 years).
20. A.I.R.(1969) S.C.1094,1098 (Shah, J.). See also Jaipur Hosiery Mills v. Rajasthan, A.I.R.(1971) S.C.1330.1331.
21. See Steel Worth Ltd. v. Assam, (1962) Supp.2 S.C.R.589,593.

understandable as the courts are necessarily handicapped because of their lack of expertise in fiscal matters and it has been observed[22] that "gratuitous judicial advice on the ~~spark~~ socialistic directions of fiscal policy is de trop".

The primary object of a taxing statute is the collection of revenue. Since taxation is also used as a measure of regulation, such regulation also may be treated as a permissible or lawful purpose for testing the reasonableness of classifications under Art.14. Hence it may be stated that the classification made in a taxing statute should have a rational nexus to one of the objects namely, raising the revenue including the plugging of loopholes in its collection[23] and the regulation of the taxed activity. The above rule applies to both the substantive as well as the procedural provisions.

In the following pages a study is attempted of the decided cases to determine how far the tests adopted by the Supreme Court of India were helpful to uphold the guarantee enshrined in Art.14 of the Constitution.

22.Krishna Iyer, J., In Murthy MatchWorks v.Asst.Collector, A.I.R.(1974) S.C.497,504.

23.Pooran Mal v.Director of Inspection,A.I.R.(1974) S.C.348, 357. The object of augumenting revenue may include encouragement of thrift and avoidance of wasteful expenditure. Prince Azam Jha v. E.T.Officer,A.I.R.(1972) S.C.2319,2324. (A classification between individuals and hindu undivided family for the purpose of including the expenditure by dependents under the Expenditure Tax Act,1957 was upheld under Art.14.)

Any discussion of taxing power in relation to Art.14 is bound to start with Ramjilal v. I.T.O.,[24] the earliest case on the point. The facts of the case were as follows. The Union of Pepsu constituted of eight princely states was inaugurated on 15-7-1948. The petitioner belonged to the former princely State of Nabha, whose administration was taken over by the Raj Pramukh(the chief executive) only on 20-8-1948. Till that time there was no income tax in Nabha State and hence on 11-9-1948 the Patiala Income Tax Act was extended to Nabha State. In fact the Patiala Income Tax Act was extended to the whole of PEPSU State repealing any corresponding law which was in force there. Later by an Ordinance the Patiala Income Tax Act was amended to increase the rate of tax. The petitioner was called upon to submit returns for the years 13-4-1947 to 12-4-1948 and 13-4-1948 to 12-4-1949. Later he was assessed on income for these previous years on the basis of the amended new rates. Hence petitioner's grievance[25]

24. A.I.R.(1951) S.C.97. The bench consisted of Chief Justice Kania, Fazl Ali, Patanjali Sastri, Mukherjea and S.R.Das, JJ., Justice Mahajan the remaining member of the Court did not take part in the case.

25. The other grievance was that as the Patiala Income Tax Act was extended to Nabha only on 20.8.1948, he could not be assessed for any period prior to that date and that such assessment was deprivation of property under Art.31. This limb of the decision is discussed in Chapter XXIII.

was that the residents of Kapurthala, one of the constituent states of PEPSU were assessed to income tax for previous years up to 20-8-1948 on the basis of rates under Kapurthala Income Tax Act. The rate under Kapurthala Act was lower than the amended rate under Patiala Income Tax Act. Hence it could be seen that the prejudice of the petitioner was two fold. Firstly, he was assessed to income tax for a period for which there was no income tax Act in his State and secondly that he was assessed on a rate higher than other assessees inhabiting different parts of the State.

The Supreme Court of India[26] repelled both arguments by holding that the aforesaid discrimination was brought out not by the Amendment Ordinance but by the fortuitous circumstance that the State of Nabha had no income tax legislation of its own prior to joining the Union of PEPSU. The assessment of Kapurthala residents were pending proceedings when the Amendment Ordinance came into force and had to be completed according to the rule that pending proceedings should be concluded according to the law applicable at that time. It

26. See A.I.R.(1951) S.C.97,100(S.R.Das, J.).

was held that such a rule was reasonable, founded upon a classification[27] permissible under equal protection clause.

The real flaw in the decision is that the Court failed to see that actually there was an absence of classification. Whether there ex were pending proceedings or not, the position is that a law cannot be retroactive and could not affect past transactions. Hence Kapurthala residents would be assessed on the rate prevailing at that time and there should be no assessment for Nabha residents upto 20.8.48.[28] The Court ought to have seen that the petitioner also was entitled to the protection of reasonable classification.The attitude of the Court was casual as no reference was made to the object of the legislation test.This sort of dealing is often seen as courts only look whether there was intelligible differentia as the basis of the classification. If the first test is found to be satisfied(in most cases there exists an intelligible differentia) the second test is not even adverted to, and the classification is upheld. For example , in V.M.Syed Mohammed, v.Andhra Pradesh,[29] the contention of the

27.The classification here was between pending proceedings and fresh xim proceedings. An intelligible differentia indeed! See Jain Brothers v. Union of India,A.I.R.(1970) S.C.778, 784 and M.M.Isphani v.C.I.T.,A.I.R.(1969) Cal.464,470 as instances of such classification.

28.Of course residents of Kapurthala would not be permitted to complain about discrimination on that score and such a classification would easily withstand the test of reasonableness.

29.A.I.R.(1954) S.C.314(S.R.Das, J.).

petitioner was that the Madras Sales Tax Act singled out certain commodities such as hides(petitioner was a dealer in hides) for imposing a purchase tax.[30] The Supreme Court held that the petitioner had not adduced any material to show that there were other dealers in commodities similarly situated. The second test to determine reasonable classification was not even adverted to here. In such cases the correct approach to be adopted is shown in a decision of Andhra High Court in Srikrishna Coconut Co v. State of Andhra Pradesh.[31] There the Andhra Pradesh General Sales Tax Act,1957 contained a list of declared goods which were taxed at the rate of two per cent. One of the items of the list was oil seeds. But coconut did appear in another list and was taxable at the rate of 3%.[32] As could be seen this was a case of further classification within the group of oil seeds. The Court held that the differentia made here was that coconut was produced in greater quantities(and hence necessarily sold in greater quantities also) and a higher rate of tax would fetch higher revenue,

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30. Ibid at 316. For some other decisions where there is absolutely no discussion of the application of the second test see Steel Worth Ltd. v. Assam,(1962) Supp.2 S.C.R.589; Southern Roadways(Pvt.) Ltd. v. Union of India,(1962) Supp.2 S.C.R.594.
31. A.I.R.(1962) A.P.375.
32. Perhaps a possible instance, where a classification made by merely naming a substance would have come through the test of ~~marxkyxmamkm~~ reasonableness even if one was to argue that the differentia was that coconut grows on the top of a tree and other oil seeds grow on plants!

which was the object of the statute. It would be rather harsh to insist that the petitioner who approached the Court should prove, for insistance as in the above case, that some other oil seed was in the same category of coconut.[34] In the Syed Mohammad Case the Supreme Court could have shown that the State of Madras was a place where a lot of business in hides was carried out and such large turnovers were intelligible idifferentia reasonably related to the object of the statute, ie. raising more revenue by taxing sales and purchases. Thus classification made on the basis of grouping towns for imposing entertainment tax,[35] the provision of Income tax Act,1922 which laid down that if a machinery was sold within 10 years to a private person other than to the Government, the allowances given under the Act would be deemed

34. The above statement, it is submitted, would lead to a test which is more vague.

35. Dhannalal v.Rajasthan, A.I.R.(1964) Raj.106,110.(People in big towns go in larger number to cinema than a small towns. Here however petitioner's theatre was situated in the railway colony beyond the municipal limits and was held to be exempted.)

to be wrongly allowed,[36] the exemption given to dealers in betel leaves on payment of Rs.10/- and obtaining a certificate[37] and the classification between food and drinks sold in a hotel where the turnover exceeded Rs.25,000/- and food and drinks sold in elsewhere,[38] have been upheld under Art.14.

As stated above, if tapping more financial resources effectively is to be a permissible object of tax legislation, then very few classifications can fall outside this object. But Art.14 also speaks of "equality before the law"

36. Chittoor Motor Tr.Co. v. I.T.O.,A.I.R.(1966) S.C.570,572 here the allowance was given as an incentive to industrial development and the provision wanted to prevent the misuse of allowance given. If sold to the Government it could be done only at the written down value.

37. Ram Bux Chaturbhuj v. Rajasthan ,A.I.R.(1963) S.C.351 the challenge was by dealers in vegetables. It could be seen that it was very difficult to collect tax from petty betel leaf dealers and this was possibly the best way.

38. Kadiyala Chandrayya, v.State of Andhra Pradesh, A.I.R. (1957) A.P.261,263(Subba Rao,C.J.). It was held that articles of food sold in hotels and restaurants would be in higher demand and they would be more prosperous also and taxing them at a higher rate was all the more reasonable; see also Andhra Pradesh v.Ramachandra Rao, (1962) 13 S.T.C.697 (A.P.).

and it means that the rich and the poor could not be taxed alike. Hence something more is attempted to be read into Art.14 and in Gorantia Butchayya Chowdhary v.Andhra Pradesh,[39] Subba Rao,C.J., observed that the classification ought to be made" to adjust the burden on a fair and reasonable degree of equality". A good illustration to the above approach is provided by the attitude of the courts in upholding the graduated scale of taxation.[40] It has been held that such an attempt to relate the payment to the capacity to pay and thus bring about a real and factual equality could not be ruled out as irrelevant.[41] Equality of taxation means equality of sacrifice.[42]

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39. A.I.R.(1958) A.P.294,297.

40. Kadija Bai v.W.T.O., A.I.R.(1969) Kar.69,72; S.S.Chandan - mull v. I.T.O.,A.I.R.(1959) Cal.444,446; K.S.Vasudevan v. Orissa, A.I.R.(1963) Ori.107.

41. Mathew ,J., in S.Koder v.Kerala,A.I.R.(1974) S.C.2272,2276.

42. Cooley, The Law of Taxation.op.cit., p.565.

A classification can be over inclusive or under inclusive. In the former case situations or classes which ought not to have been included are brought withinthe ambit of the law and in the latter case situations or classes which ought to have been ordinarily included are left out. In either case it does not seem proper[43] to strike down the classification as a whole unless it is incapable of extrication into the good and the bad or it is so patently arbitrary and unjust.

The defect of over-inclusive classification usually results in incidental hardships to the individual. In such cases he finds himself being classified with persons who are not similarly situated So essentially in all such cases the complaint will be the absence of a further classification which would have taken him out of the group. But such

43. A Contrary view is expressed by Bose, J., in Bidi Supply Co. v. Union of India, A.I.R.(1956) S.C. 479,486 and Fazl Ali, J., in West Bengal v. Anwar Ali, A.I.R.(1952) S.C.75,84.

complaints are seldom taken seriously by the courts because of the deference shown towards the legislative classification and the reluctance to interfere is fiscal matters. In Murthy Match Works v. Asst. Collector,[44] the facts were that the former system of classification on the basis of the quantity of safety matches produced in a factory for the purpose of the levy of excise duty was altered and the duty was levied on the basis whether safety matches were manufactured by the aid of power or not. This new classification was harsh on small scale manufacturers who were formerly entitled to concessional rates.[45] Rejecting the contention, it was held that the court could not strike down a taxation statute because there was room for further classification(micro classification). The decision clearly brings out the futility of the tests of reasonable classification when applied to such cases.[46] In Balaji v. I.T.O.,[47] the challenge was that Section 16(3) (a) (i) and (ii) of Indian Income Tax Act,1922 provided for

44. A.I.R.(1974) S.C.497.

45. Ibid at 505.

46. Here the differentia adopted, namely, the mode of manufacture is based on an intelligible differentia and has a clear nexus to the object of taxation.

47. A.I.R.(1962) S.C.123 followed in H.C.Mehra v. C.I.T., A.I.R (1966) Pat.187; see also Narasa Reddy v. I.T.O.Nellore, A.I.R.(1960) A.P.614, an earlier case on this point.

inclusion of income of a person's wife and minor children to that of the assessee.[48] The object of the provision was to prevent evasion of income tax. Here the petitioner and his wife formed a partnership and his minor children were admitted to the benefits of the partnership. Petitioner's contention was that although theprovision was reasonable to prevent evasion of tax, in his case the partnership was a genuine one and should have been excluded. The contention was repelled on the view that causing of incidental hardship was not at all a consideration under Art.14. Apart from the genuineness of petitioner's claim, in such cases the court can use a doctrine namely "separability in enforcement"[49] to confine the operation of the section to cases to which it should apply. This doctrine can be made use of only in cases of over inclusive classifications and in a case of under inclusive classification the court can step in only by striking down the provision of the law.

With respect to under inclusive classifications it is well settled[50] that a statute is not open to challenge merely because it taxes only some persons or objects and not others.

48. A further classification by the same section between minor child and married minor daughter(the latter's income not added to that of her parents) was upheld in G.K. Devarajulu v. C.I.T., A.I.R. (1963) Mad.183,185-186.
49. First laid down in Bombay v. United Motors, A.I.R. (1953) S.C.252. This doctrine is seldom made use of.
50. See Jaipur Hosiery Mills v. Rajasthan, A.I.R.(1971)S.C. 1330,1331.

It is only when within the range of its selection the law operates unequally and cannot be justified on the basis of a valid classification that there would be a violation of Art.14. The decisions show such a challenge is difficult of proof in a court of law. In East India Tabacco Co v.Andhra Pradesh,[51] sales tax was imposed on virgina tobacco alone and ~~xx~~the other varieties were not liable to tax and it was upheld as a reasonable classification. On the discretion of legislature to tax certain objects while leaving others from the liebility to tax Willis[52] observed that such classification must have some basis other than mere caprice and as an illustration spoke of a tax on white horses alone.

In Spenser & Co., v. Mysore,[53] the classification was between vacant land and land appurtenant to any building used as garden or ground for the more beneficial enjoyment not exceeding thrice the area occupied by the building. The latter was treated by the Legislature as part of the building and no tax was payable. Upholding the classification, it was held that in cities like Bangalore land was ~~xxxxxx~~

51. A.I.R.(1962) S.C.1733. See also Jagannath v. Union of India,A.I.R.(1962) S.C.148, where different rates of excise duty on different types of tobacco were upheld; Nabha Rice & Oil Mills v.Punjab,A.I.R.(1963) Punj.549,555 (a purchase tax on oil seeds alone was upheld.).
52. Willis,ConstitutionalLaw,op.cit., p.596.
53. A.I.R.(1971) S.C.1321,1325.See Anant Mills v.Gujarat,A.I.R (1975) S.C.1234,1247.(conservancy charges at a higher rate on certain properties was upheld.).In S.R.Das v.Agri.I.T.O. (1972) Tax.L.R.2101(Ori.) a provision that expenditure by Wakfs created for the benefit of family members shall not be entitled to exemption from tax was upheld; Krishna Prasad v.Asst.Controller,(1973) Tax.L.R.704(A.P.) the levy of estate duty at a different rate on the share of a deceased coparcener of a mitakshara family was upheld under Art.14.

scarce and excessive use of land as garden and ground was not in public interest and legislature could validly tax such excess land on a different basis(i.e. on market value). Such taxation of certain commodities alone may be permitted because such commodities were the main products of the State[54] or special circumstances attendant thereto justify such special treatment.[55] In Devi Das v. Punjab,[56] the Punjab General Sales Tax Act,1948 imposed a purchase tax on dealers who purchased goods for using them in production or manufacture of other goods. It was held that the underlying object of such a provision was to tax the purchase of certain goods which when once used in production or manufacture of some other goods lost their identity and were no longer taxable as such. In the case of dealers who were not manufacturers or producers there was no such metamorphosis and the taxable event still remained the sale. In an earlier case, Steel worth

54. Khyerbari Tea Co. v. Assam, A.I.R.(1964) S.C.925,941(tea and jute were taxed under Assam Taxation(on Goods Carried by Road or Inland water Ways) Act,1961).
55. Western India Theatres v. Cantonment Board, Poona, A.I.R. (1959) S.C.582,585. Two theatres of the appellant were taxed at higher rates. It was held that they were situated in fashionable and busy localities, where the number of visitors were more numerous and in more affluent circumstances than in other places.(S.R.Das,C.J.)
56. A.I.R.(1967) S.C.1895,1904.(Subba Rao, C.J.); Hiralal Rattan Lal v. S.T.O., A.I.R.(1973) S.C.1034,1039.

Ltd. v.Assam,[57] The Assam Sales Tax Act,1947 imposed a purchase tax on a dealer who was a manufacturer but exempted a person who used the goods in execution of any contract.On a challenge based on Art.14 the Court refused to examine the object of such an exemption. It seems that it was on the view that the State could not tax work contracts. But that does not apply to purchase by a contractor. It was also held that provision against discrimination under Art.14 was not on articles but on persons.[58]

In a recent decision T.G.Venkataraman v. Madras,[59] the question was again considered in detail. Here the Madras General Sales Tax Act,1959 taxed transactions in"cane jaggery" from 1967 onwards while'palm jaggery' was exempt from sales tax.The Court rejected the contention that it amounted to unlawful discrimination[60] and held that both cane jaggery and palm jaggery were commercially different commodities, were sold for different purposes and consumed by different sections of the community. But perhaps the use that could be derived from both is the same and the judgement is silent on this point. The real differentia lay, it is submitted,in the fact that production of palm jaggery was on the lines of a cottage industry in smallquantities and imposition and collection of tax would not help to increase the revenue of the State.[61]

57.(1962) Supp.2 S.C.R.589(Kapur,J.).See also Southern Roadways (pvt) Ltd. v.Union of India,(1962) Supp.2S.C.R.594(No development rebate was allowable to office appliances and road transport vehicles under Income Tax Act.Without looking at the object of the provision,it was upheld.

58.(1962) Supp.2.S.C.R.589,593.

59.A.I.R.(1970) S.C.508.(Shah & Mitter,JJ.)~~(60)Ibid at 511~~.

60.Ibid at 511.

61.That too when State has to give assistance to cottage industries.

Discrimination resulting from fortuitous circumstances arising out of particular situations in which some of the tax payers find themselves is not hit by Art.14 - if the legislation as such is of general application and does not single them out for special harsh treatment. Advantages or disadvantages to individual assessees are accidental and inevitable[62] and are inherent in every taxing statute as it has to draw a line somewhere and some cases necessarily fall on the other side of the line. The point is illustrated by two Supreme Court decisions. In Khandige Sham Bhat v. Agri.I.T.O., the Travancore-Cochin Agricultural Income Tax Act was extended to the Malabar area on Nov.1,1956 after formation of the State of Kerala. Prior to that date there was no agricultural income tax in that area. The challenge under Art.14 was that the income of the petitioner was from arecanut and pepper crops, which were harvested after November in every year while persons who grew certain other crops could harvest before November and thus escape the liability to pay tax. It was held that that was only accidental and did not amount to violation of Art.14.

62. Khandige Sham Bhat v. Agri.I.T.O., A.I.R.(1963)S.C.591,597 (Subba Rao, J); Premier Automobiles v. S.N.Srivastava, A.I.R.(1970) S.C.1386,1389. In this case the provisions for collection of advance tax from agents of non resident principals in the capacity of representative assessees under Indian Income Tax Act,1961 was unsuccessfully challenged for hardship caused to the representative assessee; see also Jaswant Sugar Mills v. Union of India, A.I.R.(1964) Punj.192,197.

In Jain Brothers v. Union of India,[64] Section 297(2) (g) of Income Tax Act,1961 was challenged as violative of Art. 14 because under Section 297 proceedings completed prior to April, 1962 were to be dealt under the old Act and proceedings completed after the aforesaid date had to be dealt with under the Indian Income Tax Act,1961 for the purpose of the imposition of penalty. April 1,1962 was the date of commencement of Indian Income Tax Act,1961. It was held that for the application and implementation of the new Act it was necessary to fix a date and provide for continuation of pending proceedings. It was also held that the mere possibility that some officer might intentionally delay the disposal of a case could hardly be a ground for striking down the provision as discriminatory under Art.14. Similarly it has been held that discrimination alleged ought to be the result of impugned legislation alone and not on a combined operation of some law passed by another legislature.[65]

64. A.I.R.(1970) S.C.778,785(Grover,J.)
65. East India S.O.D. v.Andhra Pradesh, A.I.R.(1962) A.P.204, 209. In Travancore Rubber & Tea Co., v. Kerala, A.I.R.(1964) S.C.572, 575 the State Agricultural Income Tax Act disallowed expenses for upkeep and maintenance of rubber trees in calculating total income. But such deduction was possible in case of tea as total income in that case was calculated under the provisions of Indian Income Tax Act, the income being partly agricultural and partly not. Held it was not discriminatory.See Mahendra Pratap v.C.T.O., A.I.R.(1965) Cal.203,206. See also a Privy Council decision Colonial Sugar Co. v. Irving,(1906) A.C.360,367.

Inequality may arise from the fact that one part of the taxing unit is subjected to a tax and another part is not so taxed or from the fact that one part is subjected to a higher rate of tax. The courts have held that there can be different laws for different parts of a territory if different conditions prevail therein. The leading case on this point is Madhya Pradesh v. Bhopal Sugar Industries [66]. Here agricultural income tax was leviable only in Bhopal area of the State and this was challenged under Art.14. The State had come into existence in 1956. The High Court of Madhya Pradesh [67] held the law to be ex facie discriminatory and it was also held that the State made no attempt to show that conditions prevailing in other areas of the State were so different and varied as to afford a sufficient justification. On appeal the Supreme Court held that neither

66. A.I.R.(1964) S.C.1179; Nazeeria Motor Service v. Andhra Pradesh, A.I.R.(1970) S.C.1864.

67. Bhopal Sugar Industries v. Madhya Pradesh, A.I.R.(1961) M.P. 282; 289; see Venson Transports v. Andhra, A.I.R.(1962) A.P. 103,105.(Madras T.P.G.Act,1952,though not applicable to Telengana area was upheld); Krishnan Nair v. Kerala, A.I.R.(1961) Ker.72,74(different rates of motor vehicles tax prevailed in T.C. area and Malabar area of Kerala State. The lower rate in Malabar was held to be reasonable as the road conditions in Malabar was not very desirable); In D.Cawasji & Co., v. Mysore, A.I.R.(1969) Mys.23,31(education cess prevailing in old Mysore area of Mysore State was upheld). See also Popular House v. Rajasthan, (1972) Tax L.R.1996(Raj.). It was held that in order to justify the existence of different rates of octroi in different parts of the state, different conditions should exist.

party had adduced any evidence[68] and the case was remanded. It is submitted that though there might be cases where such different laws exist in different parts of a state, here the case was one of in-action by the State in passing uniform laws even after four or five years of reorganization of the State. In Bhaivalal Shukla v. Madhya Pradesh,[69] the point raised was that in State of Madhya Pradesh there was as many as four sales tax legislations in force and in the result a person residing in former Madhya Bharat was not under liability to pay sales tax on works contract[70] while persons residing in former Vindhya Pradesh were liable to pay tax on works contract.[71]

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68. A.I.R.(1964) S.C.1179,1183-1184.
69. A.I.R.(1962) S.C.981.988. See also Instalment Supply(Pvt.) Ltd. v. Union of India A.I.R.(1962) S.C.53,59; S.C.53,59 South India Corporation v. Secretary, Board of Revenue, A.I.R.(1962) Ker.72,78.(The latter decision was reversed on appeal on another point in South India Corporation v. Secretary, Board of Revenue,A.I.R.(1964) S.C.207
70. See Madras v. Gannon Dunkerley,A.I.R.(1958) S.C.560
71. This was because Parliament had power to tax such contracts and when it conferred power on Central Government to extend any law in force in Part A States to Part C States, such plenary power was enjoyed by the executive and the C.P. & Berar Sales Tax Act was no extended to Vindhya Pradesh by the Central Government in 1949.

It was held that the differentia arose out of historical and constitutional reasons and it was upheld. One wonders whether a more stringent enforcement of equality would not have compelled the State to reform the law rather than continue it by enforcing different laws in the same state simply because there was a judiciary prepared to find out excuses for most things.

It is law that tax might be imposed only on a part of the territory for good and valid reasons. In Gopal Narain v. Uttar Pradesh,[72] house tax and scavenging tax were imposed in civil lines of the Bareilly Municipality, and the old city and the cantonment area were excluded. Upholding the levy it was held that such separate taxation of one part of the taxing unit was for special treatment and that the area of civil lines

72. A.I.R.(1964) S.C.370,375; See also Municipal Board of Bareilly v. Kundanlal, A.I.R.(1959) All.562 (F.B.) (Raghubar Dayal, J., dissented on the view that it was an uncanalised power. Here a house tax had been imposed in one ward only and was prima facie discriminatory).

had always been so treated for the purpose of development. It is submitted that there is nothing inherently wrong in such partial taxation where the benefits from such taxation are special(here to the inhabitants of the civil lines). In such a case it is all the more reasonable that the other persons who are not beneficiaries are not taxed. The decision is correct as it would have been really unreasonable if the tax had been levied on the inhabitants of the old city and cantonment for the benefit of the inahbitants of the civil lines. But this cannot be said of the other decisions in this area of classification on the territorial basis, and this is one of the areas where the effectiveness of the tests of reasonable classification completely breaks down.

Some of the other classifications upheld as reasonable by the courts are as follows. In Thirumal & Co. v. C.I.T.,[73] the diminishing rate of rebate in assessing super tax when a company declared dividend in excess of 6% of the paid up capital was upheld as related to the object, namely, prevention of evasion of tax. The classification between declared and non declared goods under Central Sales Tax Act, 1956,[74] between a licensed and an unlicensed dealer,[75] found in sales tax legislations, between cemented roads and tarred roads for the

73. A.I.R.(1964) Mad.13(a case of corporation tax).
74. M.A.Abbas & Co. v. Madras,A.I.R.(1962) Mad.457,458(declared goods are of special importance in Inter-state trade or commerce and taxed at a lower rate even for intra state sales).
75. Allauddin Sahib & Co. v.C.T.O.,A.I.R.(1958) A.P.425; Madras v. K.H.Chambers Ltd,A.I.R.(1955) Mad.314.

purposes of taxing Vehicles,[76] between assessees whose assessment orders have been set aside on appeal and remanded for fresh assessment and others,[77] between the assessees who are nationals and foreigners[78] and between an assessee's spouse and minor children and other persons, who wholly and mainly depend for maintenance and support on the assessee, to calculate expenditure[79] under the Expenditure Tax Act,1957 were all upheld by the courts.

Power of Exemption and Equal Protection:

The legislature should normally imposes the tax on all goods or persons which fall within the classification.The statement that the legislature is free to select subjects of taxation implies the power to grant exemptions therefrom. The power to grant exemption is, theoretically speaking, an exercise of the power of sub classification.Even though the power to exempt is as wide as the power to tax, it has to be exercised subject to Art.14 as it involves the question of sub classification. Hence the exercise of the power to exempt from taxation, which presupposes that the exempted category

76. Sainik Motors v.Rajasthan,A.I.R.(1961) S.C.1480,1486,(related to cost of construction and maintenance).
77. Ganesh Nayak v.C.T.O., A.I.R.(1964) Mys,240,243.
78. Amalgamated Tea Estates v. Kerala,A.I.R.(1974) S.C.849 (a higher rate of tax on foreign companies was upheld as a good part of the income of such companies would be drained out of India.).
79. Prince Azam Jah v.E.T.Officer, A.I.R.(1972) S.C.2319, 2324; Rajkumar Singhji v. Commr.Exp.Tax.,A.I.R.(1968) M.P.107,112.

would normally fall within the classification should be based on the principles of public policy[80], that is to say, that public interest should be furthered by the exemption granted.

Usual types of exemptions found in taxation statutes are the prescription of a lower limit below which no tax is payable[81] and that the power to commute or compound the tax payable under the statute. Such provisions rest on the principle that the burden should be borne mainly by those who are rich and financially solvent and also on reasons of administrative convenience as to the difficulties in the collection of tax. The second type of exemptions found in taxation statutes are in favour of cottage industries[82], co-operative

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80. K.T.Moopil Nair v. Kerala, A.I.R. (1961) S.C.552,558. It has been stated that exemptions "are granted on the theory that they will benefit the public generally or as a reward or compensation for services rendered in the performance of some function deemed socially desirable" and that "exemptions are favoured on the theory that the concession is a quid pro quo for the performance of service essentially public by which the State is relieved protanto from performing". 84 C.J.S.p.414.

81. The exemption under Madras Land Revenue Surcharge Act, 1954 to persons who pay less than Rs.500/- was upheld in C.V. Rajagopalachariar v. Madras, A.I.R. (1960) Mad.543,547. In Pithapuram T.T.C.& S.M.Union v. Andhra Pradesh, A.I.R. (1958) A.P.558,564, the Court upheld the exemption of certain goods under the Sales tax Act as most of the dealers in exempted commodities had low turnovers.

82. Mahendra Pratap v. C.T.O., A.I.R. (1965) Cal.203,206.

societies,[83] village artisans,[84] for the encouragement of manufacturing and other new industries[85] and for the support of educational, charitable or religious institutions. This type of exemption has always found favour with our courts as being in the nature of incentive and from a "prevailing belief that it is the policy and the interest of the State to encourage them."[86] Such exemptions are upheld by courts even though the general rule is that though exemptions may be granted on the basis of the use to which a property is devoted, exemption should not be granted on the basis of ownership, where same kind of property owned by others are taxed.[87] It may be said that in such cases exemption should not be granted to favour particular persons at the expense of other tax payers generally or to lessen the burden of individual tax payers. Recently in *Charian* v. *Kerala*,[88] the validity of S.21 of Kerala Motor Vehicles Taxation Act,1963, which gave a 50% reduction of tax to co-operative societies was challenged. It was brought out in evidence that there was only one co-operative society inside the State satisfying the conditions laid down in the impugned provision and that the object was only to confer undue

83. *Shri Rama Sugar Industries* v. *Andhra Pradesh*,A.I.R.(1974) S.C.1745; *Orient Weaving Mills* v. *Union of India*,A.I.R.(1963) S.C.98.
84. *Epari Chinna Krishna Moorthy* v.*Orissa*,A.I.R.(1964) S.C.1581.
85. *Andhra Sugars Ltd*. v.*Andhra Pradesh*,A.I.R.(1968) S.C.599.
86. See *Cooley*, Constitutional Limitations op.cit., p.1089.
87. See Cooley,The Law of Taxation op.cit.,p.594.
88. (1974) K.L.T.179.

and undeserved benefit to it and to create unhealthy competition to the detriment of others. The selection was struck down as violating Art.14. In Orient Weaving Mills v. Union of India[89], the exemption from payment of excise duty to co-operative societies was on condition that no member should own more than 4 looms. It was held that the exemption was really in favour of small weavers owning not more than four looms and the fact that they have combined together their efforts should not act against them. This type of exemption is a question of legislative policy and is sometimes extended to charitable and other institutions functioning not on profit motive.

The third type of exemption found is based on the principle of capacity to pay and again determined by the type of business. Thus in British India Corporation v. Collector, Central Excise[90], excise duty on foot wares was levied only on manufacturers employing more than 50 employees. The contention was that large number of workers were necessary for mass production and that did not introduce any change in the method of production or nature of manufacture and the classification was challenged as discriminatory. It was held that the big manufacturers were a well defined class and could effect economy in the process and protection was necessary to small manufacturers.

89. A.I.R. (1963) S.C.98 (exemption was by Union Government under power conferred by the legislation. This aspect of delegation of power is dealt separately in Chapter III.
90. A.I.R. (1963) S.C.104.

The fourth type of exemption which has come before courts is the exemption granted to innocent and bona fide persons who had not collected the tax to be handed over to the state on the reasonable belief that such tax could not be collected. This type of exemption usually finds its place in taxation laws which retrospectively validate a levy of tax struck down earlier by the courts. In Jonnala Narasimharao & Co. v.Andhra Pradesh,[91] the Andhra Pradesh General Sales Tax (Amendment) Act,1970 had exempted commission agents from payment of tax for a period if they were able to prove that they had in fact not collected the tax for the relevant period from their principals. Upholding the validity of the provision, it was held that the exemption in their favour was valid as they had not collected the tax in view of the law as it stood then.[92] A similar challenge was turned down in International Cotton Corpn. v.C.T.O.,Hubli,[93] where the Central Sales Tax (Amendment) Act,1969 had exempted dealers who had not collected the tax for a certain period.

In case where an exemption is challenged as an unreasonable classification the court had to see the object or

91.A.I.R.(1971) S.C.1507.

92.The Court pointed out that the persons who had collected the tax illegally(in the sense that at the time of collection the law did not authorise it) could not complain as what the State attempted to recover from them was the amount collected by way of tax from the public and not anything more. Ibid at 1510.

93.A.I.R.(1975) S.C.1604,1610.

the dominant purpose of the exemption. In Vivian Joseph v. Bombay Municipality,[94] the exemption granted to building of co-operative housing societies from tax under the Bombay Buildings Repairs And Reconstruction Board Act,1969, which imposed a levy on buildings to meet the expenses in carrying out structural repairs to residential buildings let out to tenants, was challenged as an unreasonable classification. The exemption was upheld as the Act had levied the tax only on rented buildings and buildings occupied by owners were exempt from tax and the Court held that there was no landlord-tenant relationship in the case of buildings belonging to co-operative housing schemes.[95]

Where the statute confers a power to grant exemption on the executive government, the latter can grant exemption subject to reasonable principles. This aspect of the problem was brought out in Shri Rama Sugar Industries v. Andhra Pradesh.[96] The Andhra Pradesh Sugar Cane(Regulation of Supply and Purchase) Act,1961, by S.21 had conferred the power on State Government to grant exemptions from tax in favour of new factories or factories which in the opinion of the Government had substantially expended. The State Government adopted a policy of granting exemption to co-operative sugar factories only.

94. A.I.R.(1972) S.C.845.
95. The Court held that in such cases the tenants had only the status of licensees, and as there was no freezing of rents, the landlords were able to effect repairs periodically. Ibid at 587.
96. A.I.R.(1974) S.C.1745.

The majority of the Court held that the Government was justified in treating co-operative sugar factories as a class by themselves.[97] Their lordships Mathew and Bhagwati, JJ.,(dissenting) pointed out that from the point of view of the object of the exempting provision, co-operative societies of sugar-cane growers and other factories stood on the same footing and there could be no justification for specifically favouring the former class of industries by confining the benefit of exemption to them and leaving out of the exemption the latter class of industries. Their lordships held"picking out co-operative society of sugar-cane growers for favoured treatment to the exclusion of other new or substantially expanded industries, is wholly unrelated to the object of exempting provision and the policy or rule adopted by the State Government is not legally relevant to the exercise of the power of granting exemption..[98]

Another aspect of the problem of exemption to which Art.14 applies is the extent or limit of the exemption. In such cases the challenge is on the ground that the limit has

97.Alagiriswami, J., wrote the majority judgement for himself and on behalf of Ray, C.J., and H.R.Khanna, J. "Sugar-cane growers have been the object of particular consideration and care of the legislature" was the only reason given at p.1748.

98.Ibid at 1755.

been fixed arbitrarily without regard to reasonable principles. In Union of India v. Parameswaran Match Works,[99] a concessional rate of excise duty was available to small manufacturers of matches who had filed declarations as provided before 4-9-1967 and the selection of that date was challenged as arbitrary.[100] Rejecting the contention,it was held that the date was so fixed for the benefit of bonafide small manufacturers and in order to deny the benefit to big manufacturers the facility to claim the concessional rate by splitting up the concern later into small units.A curious contention was raised in International Cotton Corpn. v.C.T.O.Hubli.[101] The Central Sale Tax Amendment Act,1969 had only exempted dealers who had not collected the tax for the period[102] from the date of judgment of the Supreme Court till the date of the Amendment Act.The contention was that such exemption should have been from the date of the earlier High Court Judgement.[103] Rejecting the contention,the Court correctly pointed out that in such cases the dealers concerned were very often the same set of dealers and there was no question of extent of the exemption. In Jaipur Hosiery

99.A.I.R.(1974) S.C.2349.The fixation of the extent of the exemption is really a problem of under-inclusive classification.

100.K .K.Mathew J.observed that there could be no doubt that any date chosen for the purpose would, to a certain extent be arbitrary and that was inevitable. Ibid at 2352; In Shanker I & S.R.Mills v. Union of India,A.I.R.(1969) Punj. 595. A provision that exemption from payment of excise duty was available to manufacturers who began to manufacture prior to 13.6.1962 was upheld.

101.A.I.R.(1975) S.C.1604.

102.10-11-1964 to 9-6-1969. The Supreme Court decision in Mysore v. Lakshminarasimhiah, A.I.R.(1965) S.C.1510 was pronounced on 10.11.1964.

103.23.1.1962 was the date of the High Court Judgement.

Mills[104] v. Rajasthan, the State Government had exempted garments of value not exceeding Rs.4/- from sales tax but excluded"hosiery products and hats" from such exemption and this was challenged on the ground that there was no rational basis of classification between garments as such and knitted garments. Even though the State did not attempt to justify the classification, the Court held that in matters of taxation the legislatures possessed large freedom in selecting persons and objects for taxation.Without adverting either to the purpose of the exemption in favour of garments or to the object of exclusion of hoisery goods from it, the Court held that hoisery articles generally were knitted ones and different from woven articles and upheld the sub-classification.

The decision in Aswattha Reddy v.Andhra Pradesh,[105] provides a clear instance of arbitrary grant of exemption.The State Government had to incur additional expenditure in an area to keep peace because of fight between two factions and two criminal cases had been registered against both the factions. The Government imposed a levy to drfray such additional expenses on the members of one of the factions only. It was held that the power to exempt was not an arbitrary power and exemption should have been given only to those inhabitants who were not responsible for the conduct which

104. A.I.R.(1971) S.C.1330.
105. A.I.R.(1966) A.P.204; See also Rajasthan v.Thakur Pratap Singh,A.I.R.(1960) S.C.1208,1210.

necessitated additional expenses.

The state may withdraw the exemption granted or may even reclassify so as to exclude a class which was believed to fall within the exemption without offending Art.14.[106] [107]

<u>Some specific decisions:</u>

A critical examination of all the important decisions where the courts have interfered to strike down the classification is necessary to ascertain the exact scope of Art.14 with reference to the power of taxation. In <u>S.C.Prashar</u> v. <u>Vasant Sen Dwarakadas</u>,[108] the facts were as follows. Under Income Tax Act,1922 normally no assessment or reassessment was to be made after the expiry of four years. Under the second proviso to S.34(3) this time limit was not applicable where such assessment, or reassessment was in pursuance of a finding or a direction by the tribunal. Here a firm was assessed to income tax and on appeal by the firm, it was discovered that the firm did business on behalf of another firm(herein the respondent). A notice was issued to reopen the assessment against the respondent and the case related to an application for a writ of mandamus to quash the notice issued in pursuance

106. <u>Thungabhadra Industries</u> v. <u>Andhra Pradesh</u>, A.I.R.(1966) A.P. 85,90.
107. <u>Epari Chinna Krishna Moorthy</u> v. <u>Orissa</u>, A.I.R.(1964) S.C.1581
108. A.I.R.(1963) S.C.1356; see also <u>C.I.T.</u> v. <u>Lakmirsingh</u> A.I.R.(1963) S.C.1394; <u>A.G.Nair</u> v. <u>I.T.O.</u>, A.I.R.(1958) Ker.248.

of the finding.The Supreme Court by a majority held that the[109] second proviso in so far as it related to a stranger to the proceedings was ultra vires Art.14 of the Constitution. The proviso was held to make a classification between assessees against whom a direction had been given by the tribunal and others against whom no such direction was given. Both these categories of persons were liable to pay tax but for some reason or other failed to pay it.The stranger to a proceedings against whom further proceedings are barred by passage of time, was held, could not be deprived of the valuable right.

The difficulty in applying the tests of reasonable classification is really brought out by the decision of the minority judges. The object of the provision was to check evasion of liability.[110] Hidayatullah, J., observed " If A keeps his money with B and this fact is discovered in the assessment proceedings against B and a finding to that effect is given, a situation arises in which the law thinks that A should be brought to book even though, if action against him were commenced in the ordinary way it would have been out of time".

109.A.I.R.(1963) S.C.1363,1365.S.K.Das,Kapur and Sarkar, JJ. Sarkar,J., delivered the main judgement in C.I.T. v. Lakhmir Singh, A.I.R.(1963) S.C.1394.Hidayatullah and Dayal,JJ., dissented.

110.A.I.R.(1963) S.C.1356,1393. It was observed that the method of tax evaders were both ingenious and varied and one such method was mixing up of incomes.

The learned judge also pointed out that the finding did not harm him and all that happened was that he was faced with an inquiry. The assessment if any followed only after notice and hearing. It is submitted that if the two tests were the criteria in determining the reasonableness of a classification it could be seen that both tests were satisfied here. A tribunal could make a finding against a stranger only if it was necessary for the disposal of the pending appeal or other proceedings[111] and hence it could be assumed that a finding against a stranger was possible only when he was intimately connected with the proceedings. Further, the accepted position of law is that a court of law is not concerned with incidental hardship to a person caused by the operation of a provision of law. Whether he loses a vested right or not is not a consideration under Art.14.[112] But the law is that the period of limitation only bars the remedy and does not take away the right[13] (here the right is the power of the officer to assess)

111. See B.Bhagwandas v. C.I.T., A.I.R.(1968) S.C.139,141.

112. ~~AxixRxix~~ Probably Art.19(1) (f) would have been attracted if it amounted to a property right.

113. Abdul Rafiq v. Bhajan, A.I.R.(1932) All.199,206; Gopal Bhaurao v. Jagannath Pandit, A.I.R.(1935) Bom.326,328.

and it has been also held that being procedural in nature[114] it does not create any right in favour of anyone. The objects of the legislation being collection of more revenue and prevention of possible evasion of liability to pay tax the provision was reasonably related to the classification. Further the differentia adopted being a finding or direction by the tribunal was also an intelligible one.

In Vedaranya Swaraswami Devastanom v. State of Madras[115], the Madras Inams(Assessment) Act,1956 which levied full assessment on inam lands was challenged as discriminatory under Art.14. In every 'inam' there was a remission of revenue in whole or part. In Minor inams, only the share of state (melwarom) is granted. The challenge was that Section 3, which was the charging section provided for assessment of all persons who owned lands tax-free and others who had only the "melwarom" rights alike though both were not similarly situated. It was held that the section was discriminatory but remedy was not given on the view that Art.31-A protected the legislation. It is submitted that Art.31-A applied only to agrarian reforms

114. Bankey Lal v. Babu, A.I.R.(1953) All.747,748.
115. A.I.R.(1964) Mad.90. (Ramachandra Iyer,C.J., and Ananthanarayanan, J.) Bringing such tax-free lands to bear the liability for the first time is not violative of Art.14. See Ratnaprova Devi v. Orissa, A .I.R.(1964) S.C.1195.(lands belonging to former rulers and their dependents were made liable for taxation).

and certain other matters expressly referred to therein and did not apply to a taxing statute. In I.T.O.Assam v. Lawrence Singh Ingty,[116] S.10(26) of Income Tax Act,1961 was challenged as the exemption given to income of members of the scheduled tribes was not applicable to government servants. The Government attempted to justify the classification on the ground that it was easier to collect income tax from government servants, and the purpose alleged was administrative convenience.[117] Rejecting the contention it was held that administrative convenience, in order to afford a just basis for classification, must be a real and substantial one. It was held that exemption given to those employed in private firms and those who carry on other professions was not based on a reasonable classification.[118]

Other decisions under this group relate to land and property taxes where it was held that tax should be related to actual or potential productivity. Here classification based on

116. A.I.R.(1968) S.C.658,661.

117. See Pannalal Binjraj v. Union of India,A.I.R.(1957) S.C. 397,410. where power to transfer cases of assessees was upheld on the ground of administrative convenience.

118. In I.T.O. v. N.T.R.Rymbai, A.I.R.(1976) S.C.670 it was held that the condition that such income should accrue inside such tribal area was valid under Art.14.

area has been held to occasion discrimination. Strictly speaking, this is a question of selection of a wrong basis or differentia for classification rather than absence of classification as was held in the leading decision, K.T.Moopil Nair v. Kerala,[119] The facts of this decision were as follows. The Travancore-Cochin Land Tax Act, 1955 levied a basic tax at the uniform rate of Rs.2/- per acre. The petitioner's grievance was that he owned considerable tract of forest land(more than twenty thousand acres) but his income was only Rs.2100/- per year. This was because, according to the petitioner, the prior sanction was necessary for cutting trees from his forest lands under Madras Preservation of Private Forests Act,1949.[120] According to the majority ordinarily the tax on land or land revenue was imposed on the actual or potential productivity of the land[121] and a uniform tax without reference to actual or potential productivity was discriminarory. It was also held

119. A.I.R.1961 S.C.552,558. Followed in P.R.Rajah v. Kerala, A.I.R.(1963) Ker.31(land cess under Madras District Boards Act.) P.R.V.Rajah, v.Dy.Tahsildar,Chittur, A.I.R.(1963) Ker.155 the court struck down Kerala Land Tax Act,1961. Later this Act was included in the IX Schedule but again challenged in M.K.Thangal v. Kerala,A.I.R.(1971) Ker.65 on the ground that the charging section was defective.
120. The majority consisted of Sinha, C.J., Imam, Subba Rao and Shah, JJ. Sarkar, J., dissented.
121. In Malabar area to which the petitioner belonged, the State was entitled to a fixed share of the produce and such settlement was usually for a period of thirty years. See Kelu Nair v. S.S. for India in Council,(1925) 49 M.L.J. 37,45.(Subramania Aiyar,J.)

that was one of these cases where lack of classification created inequality.[122] But as Sarkar, J., pointed out the[123] classification of land and the differentia employed were area of land held by a person. This was an intelligible differentia. The object of the statute was to provide a low and uniform rate of basic tax(ie. 2 paise per cent). The differentia was thus reasonably related to the object of legislation.

It is submitted that the majority decision based on Art.14[124] is against the well established principles of reasonable classification. This was a case where the twin tests had been satisfied and in such cases the rule is that the court should not prescribe another basis for classification even where the one provided by the legislation was fanciful or arbitrary. The old procedure of land revenue being a share of the produce is not a rule of law beyond the power of legislature to change. It is true that the provision would have worked injustice in the case of the petitioner if the facts alleged were true. But Sarkar, J., pointed out that it[125] ~~is~~ was not proved that the land was devoid of any income other than the income from the forest standing on it. Even so the proper provision to apply was Art.19 and not Art.14. Instead of testing the reasonableness of the classification, the majority simply held that there was absence of classificat-

122.A.I.R.(1961) S.C.552,558.
123.Ibid at 560.
124.The Court also struck down the Act ultravires Art.19(1)(f) on the view that it was confiscatory in nature, see Chapter XIII.
125.Ibid at 563.

ion.[126] The tax on land may be defined as a sum of money legally claimable by the state from any person on account of any land held by or wested in him. The tax was further not on income from land(ie. agricultural income tax) and it seems possible that the same argument of no income could be raised in the case of wealth tax also.

The dictum that a uniform rate of tax irrespective of productivity is invalid has been applied to tax on buildings[127] in Bhuvaneswariah v. Mysore[128]. Here the Mysore Building Tax Act, 1962 which levied tax on a floorage basis was struck down on the ground that floorage basis was both unscientific and sometimes arbitrary and mechanical.[129] Taxation on floorage basis has been held bad by Supreme Court in N.M.C.Spg. & Weaving Mills v. Municipal Corporation, Ahamadabad,[130] and Kerala v. Haji K.Kutty Naha.[131] In Andhra Pradesh v. Nalla Raja Reddy,[132] the Andhra Land

126. Seervai H.M., Constitutional Law of India (1967), p.372 takes the view that so far as forest lands were concerned the doctrine of severability in enforcement could have been applied. It is settled law that the burden to show that a uniform rate offend Art.14 is on the person who challenges such levy.
127. Probably on the view that entry 49 of List II, Seventh Schedule to the Constitution provides "Taxes on land and buildings".
128. A.I.R. (1965) Mys.170,183,208.
129. Hegde, J., at 183, the other judge Govinda Bhatt, J., also struck down the act as a colourable piece of legislation as the object of legislation was to recover "shy money". This view is wrong as doctrine of colourable legislation applies only to legislative power and not to motive of the legislation. cf. Lokamanya Mills v. Barsi Municipality, A.I.R. (1968) Bom.229,245 (Tarkunde, J.) See also Gajapati Narayan Deo v. Orissa, A.I.R. (1953) S.C.375.
130. A.I.R. (1967) S.C.1801 (Bombay Muni.Corpn.Act, 1949).
131. A.I.R. (1969) S.C.378 (Kerala Building Tax Act, 1961).
132. A.I.R. (1967) S.C.1458.

Revenue (Additional Assessment) and Cess RevisionAct,1962 was impugned under Art.14. The Act was passed to bring about uniformity between Telengana region and the rest of the State in the matter of taxation and to raise the revenue in view of rise in prices and to make the ryots bear equitably their share of the burden of the development plan. Section 3 of the Act classified lands into 'dry lands' and 'wet lands'. In the case of the former the levy was raised by 75% subject to a minimum of 50 p. In the case of wet lands, they were divided into four groups on the basis of extent of ayacuts and whether water was supplied from a government source of irrigation. Maximum and minimum rates for each kind were also specified according to whether it was single or double crop land. It was held that the tax on dry land was on a flat rate and was ultra vires Art.14. The tax on wet land was also struck down as the classification based on ayacut was held to have no reasonable relation to the duration of water supply.[133]

The court has stood very steadfastly by the old "scientific[134] formula of levying land revenue on the basis of quality and productivity of soil. In none of the cases discussed herein there existed the prejudice alleged in K.T.Moopil Nair case. It is also submitted that in the case of agricultural land the new system is to levy a low rate of basic tax and an

133.A lot of data is given at p.1467 on this point.

134.See Subba Rao, J. Ibid at 1464.

agricultural income tax on the income if any therefrom. Such a basic tax was all the more necessary at that time for the purpose of levying agricultural income tax as the definition[135] in Income Tax Act, 1961 specified that the land should be assessed to land revenue. In case of tax on buildings, this tax is levied by states and the tax on income therefrom is levied by the Union Government under the Income Tax Act. Further it is not shown in any of the cases that the tax exceeded the income from the property because the "unscientific" formula was applied. In Kerala v. Haji K. Kutty Naha,[136] the Kerala Building Tax Act, 1961 had exempted the first thousand square feet and the tax ranged from 10 p. for 2000 sq.ft. to 50 p. for over 12000 sq.ft. In Bhuvaneswariah v. Mysore,[137] the Mysore Act had made a twofold classification. Firstly, 121 towns were classified into three categories specifying different rates of tax. Secondly, there was a further classification between residential and non residential buildings, the exemption being first 1000 sq.ft. for residential buildings. It could be seen that these Acts would not have created such a strange situation as in K.T.Moopil Nair case.

The question remains whether it is absolutely necessary to impose the tax on property and buildings on the basis of income therefrom to render the tax one based on

135. Before the Amendment of the definition by Taxation Laws (Amendment) Act, 1970, the position was that the income from government land given on lease was not liable. Joseph Chacko v. Agri.I.T.O., (1969) K.L.T.406.
136. A.I.R.(1969) S.C.378.
137. A.I.R.(1965) Mys.170.

reasonable classification under Art.14. In Spencer & Co. v. Mysore,[138] the question was not answered as the tax was based on market value which the Court held bore a definite relationship to the actual or potential income of the land and there could be no objection to a levy at a uniform rate. The issue again came before the Supreme Court in Twyford Tea Co. v. Kerala,[139] where the validity of Kerala Plantations (Additional Tax) Act, 1960 as amended by Amendment Act,1967 which imposed a tax at the rate of Rs.50/- per hectare was challenged as not based on the yield from the land. The area of plantation[140] was determined as a quotient obtained by dividing the total number of trees by different numbers[141] in certain cases or the actual extent which gave yield in other cases.[142] If the area so determined was larger than the actually cultivated area the tax was payable only in respect of the actually cultivated area. The contention of the petitioners was that the actual yield from these plantations in different areas of the State were different and hence a uniform rate of tax was discriminatory. Rejecting the contention, the majority of the Court[143] held that though a uniform rate of tax fell more heavily on some plantations than on others because profits were widely discrepant, if that was

138.A.I.R.(1971) S.C.1321. The tax was at the rate of 4% on the market value of vacant lands in the Bangalore City. Earlier the Madras Urban Land Tax Act,1966 which imposed a tax on the market value and was upheld in Asst.Commr., Madras v. B & C.Co., A.I.R.(1970) S.C.169.
139.A.I.R.(1970) S.C.1133.
140.Coconut,areacanut, rubber, coffee, tea, cardamom and pepper cultivations were plantations under the Act.
141.200 in the case of coconut, 1500 in the case of areaanut etc.
142.In the case of tea or cardamom.
143.Hidayatullah, C.J., Vaidyalingam and Ray, JJ.

discrimination "hardly any tax direct or indirect would escape the same censure."[144] The majority held that that was not a case where barren lands had been subjected to an equal tax with productive lands and the method of calculation under the impugned Act to find out the area of plantation was held to equalise the different plantations for purposes of taxability. Their lordships Shelat and Grover, JJ., dissented on the ground[145] that land should have been classified and incidence of tax graded according to productivity and other relevant factors. The absence of such a classification based on the productivity was held to result in unequal incidence of the tax on those who held the land.

The tendency is apparently to apply the dicta in K.T. Moopil Nair case only where lands or buildings, which have apparently no income, are taxed along with others which produce income.[146] Such a view would also relieve the courts from suggesting other basis of classification to the legislature.

Statutory provisions found in taxation statutes to check the evasion of tax have to be based on the principle of reasonable classification. The power to demand advance tax from an agent of a non resident assessee was upheld in Premier

144. A.I.R.(1970) S.C.1133,1136. In Kerala Wakf Board v. Union of India, A.I.R.(1975) Ker.123 a uniform rate of fee imposed on the income of Wakfs was challenged as discriminatory without success.
145. Ibid at 1145.
146. Anyway such a view has no application outside taxation on lands and buildings seem to be beyond doubt. See Dixit, C.J., in Delite Talkies, v. Jabalpur Corporation, A.I.R. (1966) M.P.298,300-301.

__Automobiles__ v.__S.N.Srivastava__ [147]. In such cases the object of such provisions is to prevent evasion of tax. So any classification based on an intelligible differentia to achieve the said objective should pass the test of reasonableness under Art.14. In such cases it is not enough for the petitioner , to challenge successfully under Art.14,to show that the statutory provisions are only partially effective to check evasion of tax.The court would not examine such a challenge as it is for the legislature to evolve fool proof methods to prevent evasion of tax and not for the courts either to suggest or to strike down existing provisions on the ground that they are not effective. In such cases the courts need only examine whether the impugned provision applied equally to all tax evaders. In __Pooran Mal__ v.__Director of Inspection__[148], the ground of attack under Art.14 was that the provisions for search and seizure were effective only against assessees who were not a astute enough to spend their income or otherwise conceal it without being traced. The Supreme Court held that it might be so but since all assessees stood equally, as searches could be made against all, Art.14 was satisfied.

147. A.I.R.(1970) S.C.1386. The ground urged, that an assessee whose previous year coincided with the financial year would escape the liability to pay advance tax,was held to be without substance. Ibid at 1390.
148. A.I.R.(1974) S.C.348, 359. The Rules 112B and 112C of I.T Rules providing for release of articles seized was upheld under Art.14 as beneficial rules in __B.P.Thakkar__ v. __C.I.T.__,A.I.R.(1976) S.C.636.

Application of Art.15 to tax laws:

Article 15(1) of the Constitution of India in categorical terms prohibits discrimination against citizens on grounds only of religion, race, caste, sex and place of birth. So any classification on the above grounds made in a taxation statute becomes ipso facto void and no question of reasonable classification arises in such cases. However,[149] if the classification is based on some other ground not prohibited by Art.15,the state may justify it as a reasonable classification under Art.14. The leading case under Art.15 is Rajasthan v. Thakur Pratap Singh.[150] The State Government imposed a levy to defray the cost incurred by it in stationing additional police force to keep peace.The Government exempted harijan and muslim inhabitants of the locality from the levy on the ground that they were members of law abiding communities.The exemption was struck down as it discriminated against law abiding members of other communities and as the basis was caste and religion.

Procedural law and Art.14.

Article 14 prohibits discrimination not only by substantive law but also bylaw of procedure.[151] A procedural provision contained in a taxation statute is liable to challenge under Art.14 as discriminatory when it is found to

149. See Vasundara v. Mysore, A.I.R.(1971) S.C.1439. A classification on the basis of domicile and not place of birth was so upheld.
150. A.I.R.(1960) S.C.1208,1210.
151. See Bidi Supply Co v. Union of India, A.I.R.(1956) S.C. 479,482.

deal with persons situated similarly in an unequal manner. Here also the two tests discussed earlier, to determine the reasonableness of a classification, are applicable.

The most usual type of procedural provisions ~~xa~~ violative of Art.14 is found in statutes which lay down two procedures to deal with persons similarly situated. In such cases where one of the procedures laid down is more onerous than the other, the first provision is usually held to be violative of Art.14. In the leading case on this point Suraj Mall Mohta & Co. v. A.V.Viswanatha Sastri,[152] the contention was that section 5(4) of Taxation of Income (Investigation Commission) Act, 1947 and S.34 of Indian Income Tax Act, 1922 dealt with the same class of persons namely, persons who had not truly disclosed their income and thereby evaded payment of income tax. The procedure under the Investigation Commission

152. A.I.R.(1954) S.C.545. This rule would not apply if there is only one procedure though it is something special. Corporation of Trivandrum v. Mohd.Haneefa, A.I.R.(1958) Ker.61,64.(F.B.) where S.409 of Trivandrum City Municipality Act which provided for realisation of arrears of tax by destraint of property and prosecution of the defaulter was upheld under Art.14.

Act was more drastic and onerous and the petitioner who was similarly situated with other persons, who had evaded tax by means of non-disclosure of their income, was selected for differential treatment under the procedure prescribed by the Investigation Commission Act.[153] This was held to be violative of Art.14 of the Constitution of India.[154] But a similar law, Travancore Income Tax Investigation Commission Act was upheld as non discriminatory in Thangal Kunju Musaliar v. Venkatachlam Potti.[155] Here section 5(1) of the Travancore Act dealt with 'substantial' profits made during war years, S.47 of Travancore

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153. In Lakshmi Bags Mfg.Co. v. Mysore A.I.R.(1969) Mys,295, 297. S.12A of the Mysore Sales Tax Act,1957 was struck down as the power exercised by the deputy commissioner under that section to assess escaped income was not subject to appeal or revision like a similar order passed by the commercial tax officer.

154. Later a uniform procedure was laid down by Section 34(1-A) of Indian Income Tax Act. Application of procedure under Investigation Commission Act to persons whose cases were referred to before 1-9-1948 was struck down in Shree Meenakshi Mills Ltd. v. A.V.Viswanatha Sastri,A.I.R.(1955) S.C.13,17-18. The same rule was applied to persons whose assessments were completed prior to the Amendment of the Investigation Commission Act was struck down in Muthiah v.C.I.T., A.I.R.(1956) S.C.269.

155. A.I.R.(1956) S.C.246.

Income Tax Act was similarly worded as section 34 of Income Tax Act, 1922 and dealt with the procedure to assess escaped income. It was held that the Travancore Investigation Commission Act dealt with war period and that the word substantial had a reasonable certainty in the background of the above circumstances.[156] It was also held that under the Travancore Income Tax Act, there should be definite information of escaped income and under the Investigation Commission Act there need only be a prima facie reason to believe that tax had been evaded. These cases related to income of years prior to the commencement of the Constitution and except for the procedure employed in assessment those actions were not capable of challenge under as Part III of the Constitution which was not retrospective.[157]

The rule against two procedures dealing with similarly situated persons or situation was applied in Anandji Haridas & Co. v. S.P.Kasture.[158] Here Sections 11(4) and 11-A of C.P. and Berar Sales Tax Act,1947 were challenged under Art.14.[159] Under Section 11(4) a registered dealer could be proceeded against at any time for not furnishing returns,

156.Ibid at 266(Bhagwati, J.) Sections 34 and 33B of Income Tax Act, 1922 were upheld in Dawjee Dadabhoy v. S.P.Jain, A.I.R.(1957) Cal.244,247.

157.cf.Ranjit Singh v.C.I.T.,A.I.R.(1962) S.C.92,96 where proceedings were completed before the Constitution and the action under I.T.I.CommissionAct was held not capable of Attack.

158.A.I.R.(1968) S.C.565 the majority consisted of Wanchoo, C.J., Mitter and Hegde, JJ., and the minority consisted of Bachawat and Ramaswami, JJ.

159.In an earlier case Ghanshyam Das v.Regional Asstant Commissioner of Sales Tax, A.I.R.(1964) S.C.766 Ragubar Dayal, J., at p.776 upheld the validity of the section under Art.14.The majority of the Court had left the question at large.

for failure to comply with the terms of the notice issued and for non proper accounting. Under Section 11A a dealer could not be proceeded against after a lapse of three years for escaped assessment. In the result though under Section 11A the three years time limit was applicable to both registered and non registered dealers, under S.11(4) a registered dealer could be proceeded against at any time. In the present case the action was initiated under S.11(4) for not filing returns. It was held by the majority that the term "escaped assessment" included all cases of nonassessment and as such[160] it was open to the authority to proceed under either of the provisions. It was also held that under Section 11(4) the appellants were deprived of the benefit of a period of limitation and therefore that Section was discriminatory and violative of Art.14 of the Constitution of India.[161] The minority judgement of Bachawat, J.,[162] pointed out that the two decisions which e were relied upon by the majority of the

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160. Following Maharaj Kumar Kamal Singh v.C.I.T.,Bihar,A.I.R. (1959) S.C.257,261.(A case under S.34(1) (b) of Income Tax Act,1922) and C.I.T.,Bombay v. M/s.Narsee Nagsee & Co., A.I.R.(1960) S.C.1232(a case under Business Profit Tax Act,1947.).
161. It was also held that the classification made between a registered dealer and a non-registered dealer had no nexus to the object ie.assessment of escaped income see A.I.R.(1968) S.C.565,574(per Hegde, J).
162. Ibid at 577.

Court to hold that non assessment due to non filing of returns also came under the term "escaped assessment", were particular judgements under different statutes where no separate, express provision similar to S.11(4) existed. In cases where an express provision like section 11(4) existed it seems doubtful whether action for non filing returns could be initiated under S.11-A. It is submitted, that the minority judgement is correct as in reality there existed no two procedures and the one prescribed by S.11(4) could not be termed onerous simply because it did not specify period of limitation.[163]

If the objects of the two procedures are different although they relate to the same subject matter, the provisions cannot be said to be ultra vires Art.14. In Maddula Appa Rao v. I.T.O.Eluru,[164] the challenge was that under Income Tax Act, 1922, Section 28 provided for penalty to be imposed for filing false returns and under Ss.51 and 52 such persons also could be prosecuted and hence discriminatory and violative of Art.14. It was held that the two provisions were designed to achieve different objects. S.18 was held to be directed at making evasion and concealment of tax unprofitable and nonremunerative and Ss.51 and 52 were held to have another object viz.,

163. The minority judgement pointed out that a registered dealer had many advantages over a non registered dealer and that the former was under a liability to file yearly returns while the latter need file a return only if demanded. Ibid at 578.

164. A.I.R.(1959) A.P.391,393.(Chandra Reddy,C.J .,& Ansari,J.)

vindication of public justice and for reimbursement of expenses in investigating the loss caused by the fraud of the assessee.

In Hukumchand Mills v. Madhya Bharat,[165] the income of the petitioner was assessed under Indore Industrial Tax Rules till 1950, when the Finance Act extended Indian Income Tax Act to that area. The Finance Act,1950 also provided that all pending proceedings under the Industrial Tax Rules should be completed under the Income Tax Act. But by inadvertance such pending proceedings were continued under the repealed rules. When this mistake was brought to the attention of the authorities a validation Act was passed. It was held that there was no discrimination.[166]

In Purshotham Govindji Halai v. B.M.Desai,[167] the ground of challenge was that S.46(2) of Income Tax Act,1922 did not lay down a uniform procedure for recovery of arrears of tax and the different state laws prevailing in different states were made use of to collect such tax arrears in different states. It was brought to the notice of the court that different procedures existed in different states, for example, even the period of detention provided for default of payment of tax was different from state to state.Though

165.A.I.R.(1964) S.C.1329.
166.Ibid at 1333. In fact it was not clear how the validating Act was discriminatory as all pending proceedings were dealt under the repealed Rules.
167.A.I.R.(1956) S.C.20. Followed in Collector of Malabar v. Erimmal Ebrahim Hajee,A.I.R.(1957) S.C.688.

each state is free to devise its own machinery for the recovery of its public dues, it could most reasonably be said that one of the objects of the formation of the Indian Union was to ameliorate even the most backward areas of India, whether it was an exprincely state or where the most barbarous autocracy prevailed, to a common levl of enlightenment, freedom and culture. The object of an equal protection clause is to assure each citizen of equal laws. Hence if one part of India enjoys for tax evasion enlightened modes of procedure, to deny it to other parts on historical reasons is to make Art.14 of no content to the latter.[168] In the present case the situation was more unreasonable in the sense that defaulters of income tax, whereever they were, constituted one class for the purpose of equal treatment under Art.14. However, this contention was rejected on the ground that people in each state were familiar with and used to coercive processes that existed[169] and that an existing machinery devised for a particular purpose could be made use of to subserve a purpose closely akin or similar to the purpose for which it had been devised.[170] The court rejected the extreme contention that a mere

168.However the courts in India have not accepted such a view and different procedures in different states have been upheld. See Mannalal v.Collector of Jhalawar, A.I.R.(1961) S.C.828,831. The courts have even upheld different procedures for realising different types of public dues in the same state.See Lachhman Dass v.Punjab,A.I.R.(1963) S.C. 222,233.

169.S.R.Das,Actg.C.J., inA.I.R.(1956) S.C.20,26.
170.Ibid at 27.

territorial classification without anything else was enough to place the law beyond Art.14.[171] But as pointed out by Chandra-sekhara Aiyar, J.,[172] there must exist some reasonable basis for differentiation and his lordship was of the opinion that there ought to be a uniform procedure regarding penalty though machinery might be different in different states.

Recently the Supreme Court of India examined the validity of S.297 of Income Tax Act,1961, which provided that in the case of assessment orders completed before April,1,1962 the penalty was to be imposed, if any, under the provisions of Income Tax Act,1922. In Jain Brothers v. Union of India,[173] the

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171. Ibid at 26.
172. His lordship concurred reluctantly" because I am not happy about the result" Ibid at 27.
173. A.I.R.(1970) S.C.778. It was held that the mere possibility of the fact that some officer might intentionally delay the disposal of a case could hardly be a ground for striking down a statutory provision. An earlier Allahabad High Court decision, Raghunandan Prasad v. I.T.A.Tribunal, A.I.R.(1970) All.620,625, observed" The measure of penalty depends upon the nature and gravity of the default committed but the time of making the assesement has no bearing whatsoever upon the penalty itself".

challenge was of the classification of assessment orders completed before Ist,April,1962.and those completed afterwords and not that the two procedures contained in the repealed Act and the new Act were dissimilar. Under S.271(2) if a registered firm was liable to penalty, penalty had to be imposed as if it were an unregistered firm. It was held that a registered firm committing default could not later complain about discriminatory treatment.

Generally tax laws provide for different modes of recovery[174] of tax and it is probable that provisions for arrest of the defaulter is onerous than provisions for distraint of goods or for filing a civil suit for realisation of tax. In such cases it is now generally held that the provisions of Art.14 have no application.[175]

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174. For general law as to the validity of different procedures under Art.14 see M.Chagganlal v.Greater Bombay Municipality,A.I.R.(1974) S.C.2009.

175. Jagadish Mitter v.R.D.Commr.,(1975) Tax L.R.965 (Ss.222 and 232 of Income Tax Act,1961).

CHAPTER XIII

TAXING POWER AND SEVEN FREEDOMS UNDER ART.19.

The Seven freedoms[1] contained in Art.19 have been considered as the basic freedoms assuring the dignity of the citizen and the essential democratic set up envisaged by the Constitution. It is no wonder that the courts are less willing to countenance any restriction which the state cannot support as reasonable under sub clauses(2) to (6) of Art.19.[2] Though the general rule is that the burden to prove that the impugned legislation is invalid as ultra vires the Constitution is on the person who challenges the validity of a legislation,[3] under Art.19 where the enactment prima facie violates the freedoms mentioned therein, the burden to prove that it is a permissible restriction being reasonable is on the state.[4] This difference of approach may also be traced

1. Freedoms of speech and expression, to assemble peaceably and without arms, to form associations or unions, to move freely throughout the territory of India, to reside and settle in any part of the territory of India, to acquire, hold and dispose of property and to practice any occupation, trade or business.

2. Generally speaking the first three freedoms may be regulated in the interests of public order and the rest may be regulated in the interests of general public.

3. cf. Charnjit Lal Chowdhury v. Union of India, A.I.R.(1951) S.C.41;45, Burrakur Coal Co. v. Union of India, A.I.R.(1961) S.C.954,963.

4. Shelat, J., in Vrajlal Ml& Co v. Madhya Pradesh, A.I.R.(1970) S.C.129.135; Gajendragadkar, J., in Khyerbari Tea Co. v. Assam, A.I.R.(1964) S.C.925,939; Mukherjea, J., in Saghir Ahmad v. Uttar Pradesh, A.I.R.(1954) S.C.728,738. For a contrary view see Krishna Iyer, J., in Banerjee v. AnitaPan, A.I.R.(1975) S.C.1146,1154.

to the wording of these rights in the Constitution itself.[5] Under Art.14 the right to equality is interpreted by courts to mean that reasonable classification as against naked discrimination is permissible. Hence a person who approaches the court with the complaint of discrimination has not onlyto provethat he was discriminated but also that such discrimination was the result of an unreasonable classification. Under Art.19, the seven freedoms are expressly conferred on the citizen and the state is permitted to make reasonable restrictions. Hence the view is that in such cases the state should justify such restrictions.

The test of "reasonableness" employed under Art.19 is different from that applied under Art.14,[6] It is well settled that a legislative provision is necessary for imposing any restrictions on these freedoms.[7] So a law which imposes restrictions has to fall within one of the sub clauses to Art.19 to be

5. It is submitted that this approach is essentially different from the one time, short lived, move in U.S.A.,to give a preferential treatment to the freedoms mentioned in the First Amendment to the United States Constitution. Further, if the American approach is taken it applies only to political freedoms freedoms under (f) & (g) of art.19(1) would have to be excluded.
6. P.B.Mukharji, J., in Surajmull Nagarmull v.C.I.T.,A.I.R.(1961) Cal.578,586. But it is true that there can be certain extent of overlapping in practice. cf. an observation to that effect in Collector of Customs v.Sampathu Chetty, A.I.R. (1962) S.C.316,325.(Ayyangar, J.)
7. See Madhya Pradesh v. Bharat Singh,A.I.R.(1967) S.C.1170,1174. An earlier decision Ram Jawaya Kapur v. Punjab,A.I.R.(1955) S.C.549 was distinguished as there no rights of the citizen were in fact affected.

sustained as a reasonable restriction. The classical test to determine reasonableness was laid down by Patanjali Sastri, C.J., in Madras v. V.G.Raw [8] in the following words.

"The nature of the right alleged to have been infringed, the underlying purposes of the restrictions imposed, the extent and urgency of the evil sought to be remedied thereby, the disproportion of the imposition, the prevailing conditions at the time, should all enter into the judicial verdict".

A law can be said to be reasonable only if it "strikes a proper balance between the freedom guaranteed under Article 19(1) (g) and the social control permitted by clause(6) of Article 19" [9]. This role of Judiciary is generally known as social engineering adjustments or compromises of conflicting individual interests [10].

The courts look at the direct and inevitable consequences [11] or at the substance of the legislation [12] in deciding its constitutional validity. The effectiveness of this rule becomes evident where the legislation is apparently innocuous

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8. A.I.R.(1952) S.C.196,200. Kapur, J., in Hamdard Dawakhana v. Union of India, A.I.R.(1960) S.C.554,559 observed that history of legislation,the purpose, the surrounding circumstances and conditions, the mischief it intended to suppress, the remedy for the disease which the legislature resolved to cure and the true reason for the remedy-all these factors ought to be taken into consideration.

9. See Chintamon Rao v.Madhya' Pradesh,A.I.R.(1951) S.C.118,119. (Mahajan, J.)
10. Pound,Roscoe The Ideal Element In Law(1958 , Tagore Law Lectures, Calcutta) P.195.
11.Bhagwati, J. in Express Newspaper Ltd. v. Unionof India,A.I.R. (1958) S.C.578,620 .
12.Mahajan, J., inDwarakadas Shrinivas v. Sholapur Spg. & Weaving Co.,A.I.R.(1954) S.C.119,124.

in nature.[13] Again the restrictions imposed on these freedoms should have a reasonable and proximate connection[14] with the grounds mentioned in Sub-clauses(2) to (6) of Art.19.[15] It is also well established that Art.19 applies to both the substantive as well as procedural provisions of a law,[16] that the term "restrictions" may amount to total prohibition[17] of the freedom in appropriate cases.

The freedom under Art.19 can be availed of only by Indian citizens and it has been held that a registered company.[18] or a local authority[19] cannot claim the freedom under Art.19. This view has led to a many practical difficulties and recently it has been held[20] that where apart from the rights of the corporation, the rights of the shareholders also were

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13. Mohd.Yasin v.Town Areas Committee,A.I.R.(1952) S.C.115; Abdul Hakim v. Bihar, A.I.R.(1961) S.C.448,456.(By a difficult procedure laid down for sanction to kill animals, the exercise of the profession of butchers was practically made difficult).
14. Supt., Central Prison, Fategarh, v.R.M.Lohia,A.I.R.(1960) S.C.633,640; O.K.Gosh v.E.X.Joseph,A.I.R.(1963) S.C.812,815.
15. The two tests are reasonableness of the restriction and that restriction should have been imposed for a purchase envisaged in the Sub-clauses(2) to (6) of Art.19. See Sakal Papers(P.) Ltd. v. Union of India,A.I.R.(1962)S.C.305,315.
16. Kantilal Babulal Bros. v. H.C.Patel,A.I.R.(1968) S.C.445,449.
17. Narendrakumar v. Union of India,A .I.R.(1960) S.C.~~xxxx~~ 430, 436.
18. State Trading Corporation v. C.T.O.,A.I.R.(1963) S.C.~~xxx~~ 1811, 1821; Spencer & Co. v.Mysore A.I.R.(1971) S.C.1321,1322.
19. Municipal Committee, Amritsar, v. Punjab,A.I.R.(1969) S.C. 1100.
20. R.C.Cooper v. Union of India,A.I.R.(1970) S.C.564,585.

impaired, the shareholders could maintain a petition claiming reliefs under Art.19. Normally a tax need be questioned only under Art.19(1) (f) and when it affects a person's trade Art.19 (1)(g) also is attracted.

Art.19 and Taxation Laws.

Though there was some doubts as to whether a tax law could be challenged under Art.19 and Art.31 to begin with, the matter was finally settled in K.T.Moopil Nair v. Kerala [21]. In the earliest case on this point Ramji Lal v. I.T.O. [22] the Supreme Court held that a challenge under Art.31(1) on the ground that the tax was an illegal deprivation of petitioner's right to property was really one under Art.265 only. It was also observed [23] that Art.31 dealt with deprivation of property otherwise than by way of imposition or collection of tax. This view was expressed as Art.31(5)(b)(i) provided that Art.31(2) would not apply to a law imposing or levying tax or penalty. Further, there was no direct challenge under Art.19 of the Constitution.

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21. A.I.R.(1961) S.C.552. Even then Judges have expressed doubts see for example Kapur, J., in C.J.Patel v. Union of India, A.I.R.(1962) S.C.1006,1035-1036.

22. A.I.R.(1951) S.C.97,discussed supra.

23. See ibid at 100. As noted earlier the case was concerned with retrospective imposition of income tax at an increased rate on assessees who were till then not liable to income tax. The real dicta was that Art.32 petition would not be for violation of a right under Art.265.

In Mohd. Yasin v. Town Area Committee, Jalalabad,[24] the petitioner was a wholesale vegetable dealer who used to auction vegetables brought by growers on a commission of one anna per rupee. The respondent Committee framed certain bye-laws under which the exclusive rights to deal in vegetables and to collect the commission were vested in the Committee. As the dealer had to hand over the commission of one anna which he had collected as a fee to the Committee[25] the provision in effect brought about a total prohibition of the business of the petitioner because if he charged an extra sum, the growers would go direct to the contractor of the Committee who charged only one anna. It was found that the respondent had no authority to levy the impugned fee. Then the question arose whether a petition under Art.32 would lie on the reasoning of Ramji Lal v. I.T.O.[26] It was held[27] that a license fee was different from income tax as without paying that a person could not carry on a business, that is to say, a prior restraint.[28] An illegal impost of such a nature was held to attract Art.32. This view

24. A.I.R.(1952) S.C.115.(S.R.Das, J.)
25. This right to collect was auctioned later to a private person.
26. A.I.R.(1951) S.C.97.
27. See A.I.R.(1952) S.C.115,117.
28. For a similar view see Venkatarama Aiyar, J., in Ananthakrishnan v. Madras, A.I.R.(1952) Mad.395,405.(The case was related to validity of stamp duty on enrolment as an advocate). The learned Judge held that there could be even taxation of fundamental rights!

that an illegal impost or a threat to realise the same was a violation of petitioners fundamental right under Art.19(1)(f) and (g) has been followed in Himmatlal Harilal Mehta v. Madhya Pradesh.[29] However, the dicta in Ramjilal case that Art.31(1) was not applicable to a tax law was reiterated in L.Hanumantappa Jamkhandi v. Union of India.[30] In this case also Art.19 as such was not invoked to test the validity of the taxing statute. The effect of the observation in the above cases was to create an impression that taxing statutes were beyond the pale of challenge under Art.19 and 31. In another Supreme Court decision Kerala v. P.J.Joseph,[31] a commission of 20% of the price imposed on excess of quota sold by a dealer in foreign liquor was challenged under Art.19 of the Constitution. The Court held[32] that a levy which was not authorised by law could not

29. A.I.R.(1954) S.C.403,405(Collection of sales tax inter-state sales); Tata Iron & Steel Co. v.S.R.Sarkar,A.I.R.(1961) S.C.65,69; Pratapchand v. Uttar Pradesh,A.I.R.(1964) All. 284.288; Dilip Kumar v.C.T.O., A.I.R.(1965) Cal.498,506; Mahendra Pratap v. C.T.O.,A.I.R.(1965) Cal.203,206.

30. A.I.R.(1955) S.C.3,4. But in this case there was considerable delay and that was one of the circumstances under which their lordships refused to interfere. Assessment was made in November,1953 and petitioner came to court only in September,1954. See also West Bengal v.Subodh Gopal,A.I.R. (1954) S.C.92,100 for a view that there was no fundamental right to immunity from taxation(Patanjali Sastri,C.J.)

31. A.I.R.(1958) S.C.296.

32. Ibid at 300.The notification authorising the levy was not published in the Gazette and the levy was held illegal.

possibly be regarded as a reasonable restriction and therefore always infringed the right under Art.19(1) (g).

The various high courts have interpretted the Ramjilal v. I.T.O. differently whenever taxing statutes,[33] had been challenged before them. In Ananthakrishnan v. Madras,[34] Rajammannr, C.J.,left open the question whether the taxing power of the state was subject to the fundamental rights contained in Part III of the Constitution. His lordship was of the view that a stamp duty on conveyance of property could be a reasonable restriction on the fundamental right to hold and dispose property under Art.19(1) (f) a stamp duty of 99% of the value of property would be unreasonable. But Venkatarama Aiyar, J., after discussing the Supreme Court decision in[35] Ramjilal case held that Part III of the Constitution was not applicable to tax laws. According to his lordship if Part III was applied to tax laws, Part XII of the Constitution would become inoperative and so the only tax which could come within operation of part III was profession tax as it taxed the fundamental right under Art.19(1)(g).[36] It is submitted that the decision is a good example of the judicial reluctance to approve

33. A.I.R.(1952) Mad.395 the levy of enrolment fee at the time when an advocate joins the bar was challenged as a rest - raint to carry on profession under Art.19(1)(g).

34. See Ibid at 403.

35. A.I.R.(1952) Mad.395,405.

36. Ibid at 408. On a parity of reasoning, it is submitted that property tax would be a tax on fundamental right under Art. 19.(f)(f).

the extreme view that every kind of normal taxation is against the fundamental rights under Part III of the Constitution. The distinction between taxation simpliciter and an unreasonable exercise of taxing power is clearly lost sight of in the above decision. The Madras High Court has followed this view that only an illegal tax would affect the fundamental right under Part III of the Constitution.[37] The only case among this group in which the High Court actually embarked on an inquiry about the reasonableness of a taxing statute was Abdul Azeez Dawood Marzook v. C.I.T., Madras,[38] where S.42 of the Indian Income Tax Act, 1922 which provided for assessment of an agent when the principal assessee was a non resident in India, was challenged under Art.19 (1) (g). The contention of the petitioner (resident agent) was that the income sought to be assessed was that of the non-resident but the liability to pay the tax fell on the agent and that too without limit to the assets of the principal in his hand. On an examination of the statutory provision, the Court[39] upheld the provision as a reasonable restriction as the agent could recoup himself when the business was of a continuous nature and in other cases he could obtain a certificate from the income tax officer as to his liability as an agent.

37. See Guruviah Naidu v. Madras, A.I.R. (1958) Mad.158,168. The case related to taking out license under Sales-Tax Act by dealers of goods which were taxable at a single point.
38. A.I.R. (1958) Mad.1 (Rajagopalan & Rajagopala Ayyangar, JJ.)
39. Ibid at 8. There is an earlier decision Mathurai Pillai v. Madras, (1954) 1 M.L.J.110,116 where a bench consisting of Rajmannar, C.J., and Venkatarama Aiyar, J., struck down proviso to S.3 of Madras Motor Vehicles (Taxation of Passengers & Goods) Act, 1952 as violative of Art.19. The proviso did not allow increase of fare in the case of operators who were charging the maximum allowable fare from the passengers.

The examination of a taxing statute under the provisions of Art.19 by the Madras High Court in Abdul Azeez case, it is submitted, involved no change of the general view held by the court that tax laws were beyond the pale of challenge under Art.19. In the aforesaid decision S.42 of Indian Income Tax Act,1922 was treated not as a main or substantial provision of the tax law but as a particular or indirect provision dealing with prevention of evasion or avoidance of tax. Such a division between main provisions in a tax law which were immune from the operation of Art.19 and incidental provisions in a tax law which are subject to the provisions of Art.19 of the Constitution, it is submitted, was an attempt to cut down the rigour of the view taken that Art.19 did not apply to tax laws.[40] In a decision from Assam High Court the Ramjilal decision was attempted to be distinguished by the petitioner on the view that only that portion of law which provided for levy or imposition of tax and assessment thereof was immune from the operation of Art.19 and provisions regarding recovery of tax were subject to Art.19 of the Constitution. This contention was not accepted by the Court. The Assam[41] and Kerala[42] HighCourts

40. Muralidhar v. I.T.O., A.I.R.(1960) Ass.76,85(D.B.).S.46(5A) of Income Tax Act,1922 which provided for attachment of debts due to an assessee was challenged under Art.19(1)(f). There was no provision for an appeal from the order effecting attachment but the court refused to examine the validity on the general ground.
41. Ramesh Chandra Dey. v. Assam, A .I.R.(1956) Ass.177,184.
42. Gopinathan Nair v. Palode Panchayat, A.I.R.(1959) Ker.43,44.

had taken view that a tax law could not be challenged under Art.19.

In Radheshyam v. Union of India,[43] Shah, J., correctly pointed out that the decision of the Supreme Court in Ramjilal case only applied to Art.31 and examined the validity of S. 49EE of Income Tax Act,1922.[44] The High Courts of Patna,Andhra Pradesh,[45] Calcutta,[46] and Punjab[47] had shown readiness to examine

43. A.I.R.(1960) Bom.353,365. The other judge S.T.Desai ,J., did not seem to agree on this point. Ibid at 375.
44. Atma Ram v. Bihar,A.I.R.(1952) Pat.359(tax on passengers and goods imposed by the State was held to have only an indirect effect on petitioner's right to carry on the business of stage carriage.(Ibid at 366); S.S.Sahai v. Bhagalpur Municipality, A.I.R.(1957) Pat.385,389(collection of tax on trade by way of license fee was held not an unreasonable restriction on the fundamental right under Art.19(1)(g)).
45. Pithapuram T.T.C. & S.M.Union v. Andhra Pradesh,A.I.R. (1958) A.P.558,563-654.(Subba Rao, C.J.,and Jagmohan Reddy, J.).It was held that if the taxes imposed were prohibitive or had the effect of imposing restrictions which were unreasonable and could not be justified under Art.19(6), they could be successfully challenged as unconstitutional. The contention was negatived as no material was adduced to prove the unreasonable nature of the salestax imposed retrospectively on tobacco.
46. Durga Prasad Khaitan v. C.T.O.,A.I.R.(1956) Cal.596.(A statutory provision in Sales Tax Act authorising the commissioner to demand a reasonable security was upheld as a reasonable restriction as petitioner had done business for a turnover exceeding three lakhs with a capital of Rs.1000/-); Shiromoni Prosad Bhakat v.Agri I.T.O.,Burdwan, A.I.R.(1959) Cal.490,493.(Aprovision of Agricultural Income Tax Act prohibiting disclosure of certain materials to assessees was upheld as a reasonable restriction under Art.19(1)(f).
47. Gopi Pearshad v. Punjab, A.I.R.(1957) Punj.45,48.(Imposition of license fee for doing business in tobacco was upheld as a reasonable restriction on the right under Art.19(1)(g).

the reasonableness of provisions contained in taxation statutes whenever the petitioners had raised such a contention. This letter view that there is inherently nothing in a taxing statute which can claim exemption from the operation of Art.19 is correct and has been endorsed by the later decisions. It is true that power to tax is an incident of sovereignty and is co-extensive with that to which to it is an incident, and everything over which the sovereign power of a state extends is an object of taxation.[48] But the statement only refers to the jurisdiction to tax and to the fact that every tax, which is levied at present and new taxes levied with jurisdiction, are not perse violative of the rights under Art.19.[49] That a tax may in certain cases violate Art.19, was finally laid down in K.T.Moopil Nair v.State of Kerala.[50]

It is submitted that it took nearly ten years for the Supreme Court to clear the confusion and misconception caused by certain observations in Ramji Lal v.I.T.Officer.[51] The eminent Judges[52] who sat in the Supreme Court when it began

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48. Douglas,J., in Tax Commission v.Aldrich,(1941) 316 U.S. 174,177; Frankfurter, J., in Wisconsin v.J.C.Penny Co., (1940) 311 U.S.435,444 called the taxation power "the most basic power of government".
49. See Bhopal Sugar Industries v.S.T.O.,A.I.R.(1967) S.C.549. 552(Shah,J.).
50. A.I.R.(1961) S.C.552.
51. A.I.R.(1951) S.C.97.
52. They were Kania, C.J., Fazl Ali,Patanjali Sastri, Mahajan, Mukherjee and S.R.Das, JJ.

functioning in 1950 and who sincerely attempted to lay down most of the principles[53] of constitutional law were successful enough[54] to preserve them till 1960, when the last Judge of that group retired. How far the change in the personnel of the highest court immediately proceeding 1960 and the eminence of the successive incumbents in the post of chief justice in the decade immediately succeeding 1960 have changed the course of constitutional law is well werth a detailed study. But it is submitted that it is beyond the scope of the present work.

In K.T.Moopil Nair v. Kerala,[55] the facts alleged in the petition disclosed very curious circumstances. The land tax payable by him under T.C.Land Tax Act,1955 was about Rs.54,000/- per year. As per his allegations in the ~~pesitisn~~ petition his income from forest lands amounted to only Rs.3100/- per year. According to him if an enormous amount was payable by him he would have to dispose of a considerable portion of his property and in a few years he will cease to own any forest land. Sinha, C.J., speaking for the majority of the Court held

53. See A.K.Gopalan v. Madras,A.I.R.(1950) S.C.27 on the relation between Arts.19,21 and 31; In re Delhi Laws Acts, A.I.R.(1951) S.C.332 on the law of permissible delegation of legislative power.
54. Chief Justice S.R.Das retired in 1960. In 1960 itself K.K. Kochunni, v. Madras, A.I.R.(1960) S.C.1080 was decided. See also Narendra Kumar v. Union of India,A.I.R.(1960) S.C. 430(that restriction may amount to prohibition);
55. A.I.R.(1961) S.C.552 the facts of this case are discussed in Chapter XII.

that the Act was confiscatory in nature.[56] It was also observed[57] thatit was not even necessary to tear the veil as was suggested in the course of the argument, to arrive at the conclusion that the Act had that unconstitutional effect. His lordship Sarkar, J., dissented[58] on this point and was of the view that it was not proved that the land was devoid of any other income. This observation shows that if the petitioner had proved to the hilt that the tax exceeded his real income from the land, Sarkar, J., also would have taken the view expressed by the majority. Hence the real difference of opinion betwsen the majority and the minority of judges boils down to a matter of proof in a writ petition.

Confiscatory Taxation.

The term confiscatory was used to mean expropriatory. In general law both these terms have reference to property and compensation. But in the realm of taxation a law might be termed confiscatory only if the tax levied would normally do away with the property or capital as such or any incident in relation to which it was taxable. For example, property worth hundred rupees if taxed at the rate of Rs.100/-

56. Ibid at 559.
57. Ibid at 559-560. S.5A of the Act was held to be an unreasoaable restriction under Art.19(1) (f) as the procedure for assessment did not provide for notice or hearing.
58. Ibid at 563. In U.S.A., It has been stated that the taxing power is virtually unlimited as long as it does not amount to confiscation. 84 C.J.S.p.46.

per year such property or capital is exhausted in that year and nothing remains to be taxed in the next year. This may apply even where the rate of tax is a little less, but the effect of such tax is to deplete the property or the capital as the case be.[59] Strictly speaking, the doctrine can be applied only in cases of land tax, wealth tax etc., where the corpus itself is taxed. In other cases it is difficult to exhaust the corpus, for example, in the case of income tax even if the legislature imposes a rate of 100% only the income or usufruct of a particular year is exhausted and the capital or property which was the source of income still remains. A very illustrative case is[60] Asst.Commr., Madras v. B & C.Co., where the Madras Urban Land Tax Act,1966 was challenged on the ground that together with the property tax imposed by the local authority and the income tax under the Income Tax Act, taxation exceeded the income from the property.[61] However, it was true that the urban land tax and the property tax together

59. The term confiscatory has also been used where the legislature provided for a penalty for nonpayment of tax within thirty days.See A.M.Sali Maricar v. I.T.O.,(1973) Tax L.R.1008(Mad.).

60. A.I.R.(1970) S.C.169.

61. The contention was that income from the property was Rs.6000/-,The urban land tax being Rs.4160/-,income tax being Rs.1234/- the total tax came to Rs.6794/. However, this cannot be the case as Income Tax Act gives exemption to property tax paid.

worked up to about 63% of the income from property. The Court dismissed[62] the contention on the ground that the two taxes being different, it was not permissible to club together the two taxes and complain of cumulative burden. The Court held that one tax could not be held to be confiscatory by considering the cumulative effect of another tax also.

In the case of indirect taxation such as imposition excise[63] of duty or sales tax the effect of an exorbitant rate of tax would only result in increasing the price of that particular commodity. A tax imposed on a particular trade or profession or on any incident thereof may have a tendency to make such trade or business unprofitable. Generally speaking such contingency cannot arise as the assessee can easily pass over the burden by way of increased charges for his goods or services. But where such price could not be increased freely by the assessee as being controlled or fixed by the government, the matter should be viewed differently. Since

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62. Ibid at 179. The reason given is not correct, it is submitted, as both taxes are imposed under entry 49 of List II.
63. Cf. Jagannath v. Union of India, A.I.R. (1962) S.C. 148 a tariff imposed on tobacco under Central Excise and Salt Act, 1944 was challenged under Art. 19(1) (g) as being excessive and virtually destroying the trade of the petitioner. It was held that the fact that the rate of imposition was heavy would not matter as the only result would be an increase in price of tobacco; Kasturchandji v. Madhya Pradesh, A.I.R. (1967) M.P. 268. The Statute prohibited the owner from passing the burden of property tax to the tenant. But its constitutionality was not examined as Art. 19 stood suspended owing to the proclamation of emergency at that time. Ibid at 275 (Dixit, C.J.).

a citizen has fundamental rights to carry on any trade and to hold property, the state cannot compel him to exercise those fundamental rights at a loss by putting restrictions on his freedom of trade and by imposing heavy taxes.[64] If approved, this is a valid ground for either striking down the tax or the other restriction which makes the tax so unreasonable.[65]

In S.Koder v. Kerala[66], The Tamilnadu Addl.Sales Tax Act imposed a surcharge on assessees whose turnover was above Rs.10 lakhs and also provided that such amount of tax should not be realised from the customers. The Court held that such inability to pass over the incidence of tax by itself would not render the tax confiscatory. A similar view was earlier taken by the Kerala High Court in KrishnanNair v. Kerala[67], where the increased rate of tax on motor vehicles could not be realised from passengers as the Government did not allow increase in the existing fares.

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64. Y.V.Srinivasa Murthy v.Mysore, A.I.R.(1959) S.C.894,896 such a challenge though raised was not considered as no material in support of that was adduced and the plea had not also been taken before the High Court.
65. The present writer has doubts whether the term confiscatory could be used in such cases.
66. A.I.R.(1974) S.C.2272,2275.
67. A.I.R.(1961) Ker.72,74. M.S.Menon, J., observed "The camel back of the tax payer- to use the words of Lord Morris- very often sustains with ease many such last straws".

Thus the general principles regarding the challenge of confiscatory nature of a taxing statute are well settled.As shown above this ground of challenge is different from the challenge of unreasonableness or of excessive rate of tax.The challenge of confiscatory nature of a tax cuts at the root of the claim by the state that the particular measure is a tax and attempts to prove that the measure is not a tax at all but only a device or subterfuge to expropriate whatever property the citizen has got.

In Jagannath Baksh Singh v.Uttar Pradesh,[68] the U.P. Large Land Holdings Tax Act,1957 imposed a tax on the annual value of land holdings. Such annual value was calculated by multiplying the rent payable, by a factor not exceeding 12½ as might be prescribed. One of the grounds of challenge was that the rate of tax was so high that the assessee will have to part with property to meet the burden of the tax and as such confiscatory in nature.[69] His lordship Gajendragadkar,J.,[70] speaking for the Court held that ordinarily a taxing statute

68.A.I.R.(1962) S.C.1563 (Gajendragadkar,J.)

69.It was held that it might be that the imposition of the tax levied by the statute was excessive and might ultimately lead to the loss of the assessee's property, but even so, it could not be said that by virtue of the Act,the property had been acquired or requisitioned. Ibid at 1572.The Federal Court of India had also maintained a similar view. See Kunwar Lal Singh v.C.P.& Berar,A.I.R.(1944) F.C.62,65-66.

70.Ibid at 1572. It is very difficult to attribute any sort of unreasonableness to the above provision as annual value is always calculated as a multiple of rent.This may be different from market value of land as annual value is related to productivity or income. How a tax on such a basis would result in assessee being forced to part with a part of the holding in every year is difficult to comprehend and no wonder that the Court found the material adduced insufficient to sustain the contention.See A.I.R.(1962)S.C. 1563,1573.

could not be challenged for high or excessive rate of tax. It was also held[71] that K.T.Moopil Nair v. Kerala, was no authority for the proposition that court could embark upon an enquiry in every case to see whether the tax imposed was unreasonably high. Regarding the nature of challenge of confiscatory character,[72] his lordship observed that such a conslusion could be reached where in passing a legislation, the legislature had merely adopted a device and a cloak to confiscate the property of the citizen taxed and where such a conclusion was reached on the consideration of all relevant facts, that was held to be a separate and independent ground for striking down the Act.[73]

The statement of law that a mere high rate of tax is not a ground for determining the unreasonableness under Art.19 has been followed by Andhra High Court, in Raghavaraju v. Revenue Inspector,[74] and the Assam High Court in Satyanarayana v. Assam.[75]

71. Ibid at 1572-73.
72. Ibid at 1572. According to his lordship such a challenge amounted to colourableness or even fraud on the Constitution.
73. Ibid. Commenting on the decision in K.T.Moopil Nair v. Kerala it was observe. "The judgement of this court shows that the confiscatory character of the levy imposed by the Act proved to be the proverbial last straw on the camel's back". That is to say the challenge is available only in extreme cases where the impugned tax really broke the camel's (Assessee's) back. See also M.K.Thangal v. Kerala, A.I.R.(1971) Ker.65,72.
74. A.I.R.(1962) A.P.415,416.(A surcharge on land revenue). See an earlier case Sesha Sarma v. Andhra Pradesh, A.I.R.(1960) A.P.461 (A mere increase in the assessment did not involve extinguishment of property or its acquisition).
75. A.I.R.(1971) Ass.83,89.

As discussed earlier an assessee would not be permitted to challenge the rate of tax as excessive as entailing loss in his trade or profession simply because by a passing over of the tax to the consumer he fears loss of market owing to increase in price of his commodity and competion in open market.[76] In Arunachala Nadar v. Madras,[77] the rate of license fee levied under Madras Commercial Crops Markets Act, 1938 was challenged as excessive as to drive a trader out of business and the Court observed that the fee did not appear to be so high as to cripple the trader's business. The decision, though earlier in time, shows a change in attitude where the levy is directly on trade. In such cases no person can conduct the business without paying it and as such is a direct restriction on the fundamental right to do business under Art.19(1) (g). A tax on profession also stands on the same footing.A tax on land may not be said to be of same catetory under Art.19(1)(f).

76.See British India Corporation v.Collector,Central Excise, A.I.R.(1963) S.C.104 (the excise duty levied was on foot wares); Jagannath v. Union of India,A.I.R.(1962) S.C.148. (It was held that a challenge that the imposition was heavy could not be entertained).

77.A.I.R.(1959) S.C.300,305. See the distinction where the challenge was that atax hindered the exercise of trade rather that the tax was confiscatory.

An extreme case of collection of money not in the exercise of the power of taxation but under the power to impose penalty is provided by the decision in Kantilal Babulal Bros. v. H.C.Patel.[78] Section 12A(4) of Bombay Sales Tax Act,1946 provided for forfeiture to the Government any amount of money collected by way of tax whether by way of mistake or not.The Court[79] held the subsection ultra vires Art.19(1)(f).

The real issue in cases where a citizen challenges a tax as confiscatory in nature is not as to the burden imposed on him but on the effect of tax on the property or trade. Hence courts have rejected the plea often put forward by assessees that more than one kind of tax imposed by the same or different authorities violate the freedom under Art. 19(1) & (g).[80]

78.A.I.R.(1968) S.C.445. The Court stopped short of calling it confiscatory.An earlier decision handed down by the Mysore High Court also lays down the same law. M.Kuppu-Swami Naickar v. C.T.O. A.I.R.(1962) Mys.183,185.
79.See A.I.R.(1968) S.C.445, 448-449(Hegde,J.).
80.Contonment Board, Poona v. Western India Theatres, A.I.R. (1954) Bom.261,265; Mathra Prasad & Sons v. Punjab, A.I.R. (1962) S.C.745,748.The position of law regarding double taxation is that unless there is an express constitutional prohibition against it,"the power to tax twice is as ample as the power to tax once" see 84 C.J.S.p.133.

Judicial Scrutiny Of Taxing Statutes.

In testing the reasonableness of a taxing statute the courts have given large freedom of action to the legislature in framing its own policy of taxation.

On analysis a taxing statute will be generally found to fall in to the following parts 1) The charging section and the rate of tax,(2) provisions for assessment of tax,(3) provisions for collection of tax and (4) provisions to check the evasion of tax. All these classes of provisions should pass the test of reasonableness under Art.19(5) and(6).

Regarding the charging section and the rate of tax, a citizen will not be heard to complain that the rate of tax is excessive. But the charging section may be successfully challenged as in Madhya Pradesh Transport Co. v.Madhya Pradesh,[81] the tax imposed was on passengers carried by the stage carriers and as the fare was not increased under Motor Vehicles Act,1939, the operators could not collect it from the passengers and had to pay the tax from their own pockets. It was held[82] that the Government was administering a valid law

81.A.I.R.(1962) M.P.108. Here the ground of challenge was not, strictly sepaking,the inability to pass over the burden of tax by owners ofvehicles, to the passengers under Madhya Pradesh Motor Vehciles (Tax On Passengers)Act,1959.

82.Ibid at 111. The Mysore High Court has taken a contrary view in Swarnavar Nashar v.Mysore ,A.I.R.(1963) Mys.49,58. The Kerala High Court in E.A.Thommen v.R.T.O.,Ernakulam, A.I.R.(1969) Ker.130,142 treated it as a matter relating to the collection of tax and issued directions to evolve a satisfactory system.

under a misconception which rendered it invalid. In Nazeeria Motor Service v. Andhra Pradesh,[83] the tax on passengers and goods was increased and the fares and freights also were increased. The contention of the operators was that they were unable to increase the fares and freights owing to competition from the railway and so their business will be virtually annihilated. Rejecting the contention, it was held that mere diminution of profits from a trade would not render thetax violative of Art.19(1)(g).

The charging sections in a taxing statute are essentially related to the legislative power conferred by the tax entries of the legislative lists. Normally the interpretation of these entries has nothing to do with the fund--amental rights under Art.19. But an abnormal or non tradition-al inclusion or exclusion may prove burdensome to an assesses to bring forth a challenge under Art.19. In Navnit Lal E. Javeri v. K.K.Sen,[84] the definition of dividend under S.2(6A) of Income Tax Act,1922 which included also a loan taken by a shareholder from the company under certain circumstances[85]

83.A.I.R.(1970) S.C.1864,1867
84.A.I.R.(1955) S.C.1375(Gajendragadkar C.J.,Wanchoo, Hidayatullah, Raghubar Dayal and Mudholkar,JJ.) Raghubar Dayal, J.,dissented.
85.These conditions were that(1) The company was one in which the public were not substantially interested within the meaning of S.23A,(2) the company was not one which was ordinarily doing money lending business and(3) the loan must have been outstanding at the commencement of share-holders previous year in relation to his assessment year.

was challenged under Art.19. Under the aforesaid section only that part of the loan, shall be deemed to be dividend to the extent the company was shown to possess accumulated profits. The grievance of the petitioner was that he ought to have been liable only for the proportionate share of such accumulated profits which he would have received as dividend and not for the entire amount. Rejecting this contention, Gajendragadkar, C.J.,[86] observed that if a company, which had made profits, instead of distributing it among the shareholders, gave a loan to one of the shareholders the object of such loan was to evade the payment of tax on accumulated profits under S.23-A.[87] It was also held that a shareholder had no fundamental right to borrow money from a company unless it was a company whose business was money lending. Raghubar Dayal, J.,[88] in his dissenting judgement held that such a provision could only reach a proportionate amount which he would have received as dividend had it been declared and the provision was held violative of Art.19(1)(f). But where a company which is not a money lending concern advances money to one of the shareholders the motive should be deemed to be tax evasion.

86.A.I.R.(1965) S.C.1375,1381.
87.Ibid at 1382-1383.
88.Ibid at 1385.

The next stage in a taxation statute is procedure for assessment. Procedure for assessment should comply with the rules of natural justice and if not, would be held an unreasonable restriction under Art.19.[89] The statute must provide for a suitable machinery for assessment not resulting in undue or excessive hardship and arbitrariness. This includes provision for notice, submission of returns, hearing and for appeal.[90] Generally, taxing statutes provide for all these elaborately and an assessee can reach the ordinary courts on a question of law in appeal or by reference.[91]

In Kantilal Babulal v. H.C.Patel,[92] the Bombay Sales Tax Act had provided for forfeiture of any amount collected

89.K.T.Moopil Nair v. Kerala ,A.I.R.(1961) S.C.552. This is the third limb of this important decision. According to Sarkar, J., who dissented, the provisions of an Act should be read so as to imply compliance with the rules of natural justice.See Ibid at 562. But it is submitted that generally such an indulgence is shown only towards pre-constitutional statutes, cf. Kishanchand Arora v. Commr.of Police, A.I.R.(1961) S.C.705, a license case and not a taxation case.

90.Regarding right of appeal with reference to fundamental rights under Art.19 see Hari Chand Sarda v. Mizo District Council, A.I.R.(1967) S.C.829,833.

91.The procedure under Income Tax Act,1961 may be taken as an example. Where the statute provides for other remedies the mere exclusion of the jurisdiction of the civil courts is not an unreasonable restriction.See Khyerbari Tea Co. v. Assam,A.I.R.(1964) S.C.925,940.

92.A.I.R.(1968) S.C.445.

by way of sales tax mistakenly or otherwise. This provision was held invalid because it had contemplated no enquiry much less a reasonable enquiry in which the person proceeded against could prove his innocence and no provision was there for appeal. In Amalgamated Coal fields v. JanapadaSabha Chhindwara,[93] it was held that the procedure provided for ample opportunity to make objections and that the demand notice in the instant case was based on figures submitted by railway companies and assessees themselves and the challenge was turned down. Even in cases where the assessment is reopened for underassessment or escaped assessment the rules of natural justice should be complied with.[94] The only exception in this rule seems to be regarding the collection of advance tax, which is not regarded as "tax" stricto sensu. The decision of the Allahabad High Court reported in Sushil Chander v. Uttar Pradesh,[96] that Art.19 is inapplicable in cases of taxation laws which provided for no appeal from an assessment order is of doubtful validity

93. A.I.R.(1964) S.C.1013,1021.(Gajendragadkar,J.)
94. Dawjee Dadabhoy v.S.P.Jain,A.I.R.(1957) Cal.244.
95. Tobacco Trading Co. v.Asst.C.T.O., I.L.R.(1957) Mad.493 advance tax is regarded only as a security which is adjusted later when tax is quantified by assessment.
96. A.I.R.(1969) All.317,326 (F.B.) The statute provided for no appeal whatsoever. Outside the realm of taxation there is high authority for the proposition that the provision for appeal is not a peremptory requirement to satisfy the reasonableness under Art.19. See Gammon India Ltd. v. Union of India, A.I.R.(1974) S.C.960,966.

in view of the decision in Ram Bachen v. Bihar.[97]

In M.Appukutty v.S.T.O.,[98] the Court examined whether a best judgement assessment proceeding should follow the principles of natural justice so as to be reasonable under Art.19.[99] Govindan Nair, J., observed that if materials available were disregarded or if the authority refused to apply its mind to the question and reached a conclusion which bore no relation to the facts before him, it was a violation of the principles of natural justice and an infringement of Art.19.

Generally, the taxing statutes provide for the deposit of the tax assessed as a condition precedent for filing an appeal or revision from the order of assessment.[100] When a person intends to challenge the constitutionality of the taxing statute itself or when his contentions are that the officer who passed the assessment order lacked jurisdiction to do so or that the assessment was bad for violating the fundamental principles of natural justice, such person

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97.A.I.R.(1967) S.C.1404,.The power of review was held to be an adequate remedy in the case of professional tax as the matter was not complicated.
98.A.I.R.(1966) Ker.55; Motipur Zamindari Co. v.Agri.I.T.O, (1972) Tax L.R.1000(Pat.).
99.Ibid at 58-59. See also Orissa v. Maharaja B.P.Singh Deo, A.I.R.(1970) S.C.670,671.
100.State v. Rustom Glass Works, A.I.R.(1965) All.124,125. See Anant Mills v.Gujarat, A.I.R.(1975) S.C.1234,1249.

may either institute a suit or approach the high court under Art.226 without pursuing the statutory remedies.[101] Regarding statutory appeal, an assessee may file an appeal without ~~fax~~ depositing the tax assessed and may move the appellate authority for an order of stay of collection of such tax as power to grant stay is incidental to the appellate jurisdiction.[102]

Provisions for recovery of tax arrears are often coercive and depends on revenue recovery legislation of the particular state concerned. The usual methods of recovery of arrears of tax are by attachment and sale of movable and immovable properties belonging to the defaulter, by his arrest and detention in prison, by appointment of a receiver for management of the defaulter's properties,[103] by providing that tax due shall be collected as a fine imposed by a criminal court etc.

The leading case regarding the customary modes of recovery is <u>Collector of Malabar</u> v. <u>Erimmal Ebrahim Hajee</u>.[104] Here the respondent was arrested under S.48 of Madras Revenue Recovery Act,1864 for default of income tax. The question

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101.<u>Dhulabhai</u> v. <u>Madhya Pradesh</u>,A.I.R.(1969) S.C.78,89-90.

102.<u>I.T.O., Cannanore</u> v. <u>M.K.Mohammad Kunhi</u>,A.I.R.(1969) S.C. 430,435.

103.These three methods are the modes of execution of a decree under the Civil Procedure Code,1908.

104 A.I.R.(1957) S.C.688. The Court held that being an arrest for recovery of a civil debt, Art.22 of the Constitution need not be complied with. Ibid at 691.

raised before the Supreme Court was whether an opportunity had to be given to the defaulter before ordering arrest and detention.[105] It was held that no such opportunity need be given and that the only requirement was that there must be materials before the collector to base his belief and a court could examine such materials. It is submitted that the decision is not correct.[106] Even under the Civil Procedure Code a judgement debtor is asked to show cause why he should not be committed to the prison for reasons mentioned thereunder. It is true that the decision was made at a time when the relation of Art. 19 to tax laws was not finally settled and as such the decision cannot be regarded as laying down good law.

Another method for quick recovery of tax is the provision for compulsory registration of all those persons who are liable to pay tax under the statute. This is usually found in sales tax legislations. Without registration a persons is not allowed to conduct business and as such registration becomes compulsory. When tax is in arrears, the concerned officer, can

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105. Ibid at 692; P.V.Seshamma v. Andhra Pradesh, A.I.R.(1976) A.P.1, 38.

106. See S.51 and Order XXI,R.37.

take action to get the registration cancelled. Hence this has been challenged as a restriction under Art.19(1) (g). In M.A.Rahman v. Andhra Pradesh,[107] the Supreme Court held that a provision for registration in such circumstances was an eminently reasonable provision to carry out the object of the Act, namely, the levy and collection of the tax for purposes of the State.[108] A person who wanted to carry on such business was free to do so and could get registration subject to the conditions laid down by the particular statute.[109] Regarding the ground of challenge that when the registration certificate was cancelled a person was precluded from doing his business it was observed, that it was one of the methods of collection of

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107. A.I.R.(1961) S.C.1471. The registration certificate of the petitioner was cancelled for not paying tax under Madras Sale of Motor Spirit TaxationAct,1939. What really happened was that the petitioner had earlier challenged the existing Hyderabad Regulation and obtained a stay regarding collection of tax from the High Court. On the misunderstanding that this relieved him from the liability to pay tax he refrained from collecting tax from the consumers. The High Court later dismissed the writ petition.

108. See Ibid at 1473(Wanchoo,J.).

109. These conditions should not put any unreasonable restrictions on freedom under Art.19(1) (g). cf.C.T.O. v. M.M. Sadi, A.I.R.(1960)A.P.246. Here the officer could demand security for registration.The provision was upheld as the respondent was in default of tax and that was why the officer asked for security from him. The Section provided for recording reasons when a demand for registration was turned down.

arrears of tax. The cancellation of registration certificate as one of the methods of collection of revenue was held to be necessary in order that the administration of the State might go on smoothy in the interests of general public. It was also pointed out that a person who was in arrears of tax might be put out of business by pursuing other methods of recovery of tax, for example, by attachment and consequent sale of the assets of his business. The Section was upheld as a reasonable restriction under Art.19 (6). It is submitted, that even though a person might be put out of business, as shown by the Court, by sale of his assets of business for realisation of tax or by incarceration behind the bars, such consequences have only an indirect effect on a persons' fundamental right to conduct trade.[110] Such procedures have been upheld because there the

110. The illustration is Sadanandan v. Kerala, A.I.R.(1966) S.C.1925 where the petitioner was detained under the Defence of India Rules, 1962 and consequentially he lost the ESSO dealership agency. It was with a motive to procure this agency to one of the relatives of an high official, the detention order was passed. But it is clear that in such cases the petitioner canoot come to court with a grievance that his fundamental right under Art.19 (1) (g) was affected.

defaulter assessee gets an opportunity to put forward his case and the procedure is in consonance with the principles of natural justice. The Court ought to have, it is submitted, examined,the provision to see whether the provision for cancellation of registration certificate was a reasonable restriction substantively and also procedurlly. ~~[illegible]~~ Substantively in the sense that the cancellation has to be done in certain circumstances laid down by the statute itself and not on the whims and fancies of the concerned authority.[111]

The system of registration certificate is generally used where the collection or levy of tax is difficult. The such cases an amount is taken as fee for registration in lieu of tax.[112] Provision of taxing statutes which makes a transferee of business liable for arears of tax where he continues under the prior certificate~~ws~~ was upheld in Bibhash Chandra v. West Bengal.[113] The decision took such a view because in those cases, the transferee could recoup the sum from the transferor. A

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111. The point is that the same principles governing the cancellation of license should apply here also. cf. Mineral Development Ltd. v. Bihar, A.I.R.(1960) S.C.471.

112. In Ram Bux Chaturbhuj v. Rajasthan ,A.I.R.(1963) S.C.351, the Rajasthan Sales Tax Act exempted betel leaf dealers on payment of Rs.10/- and on obtaining a certificate. The provision was upheld as a reasonable restriction under Art.19(1)(g).

113. A.I.R.(1963) Cal.578,580-581.

similar provision, generally found in municipal legislation, is for recovery of property tax from the occupier(tenant) of a building in certain circumstances. Here the tenant is given statutory absolution regarding rent to that extent. In such cases the transferee should be given an opportunity before proceeding against him as he is not primarily responsibile for the sum. In Khan Bahadur W.Rehaman Tea and Lands Co. v. Gift Tax Officer,[114] the provision under Gift Tax Act for recovery of tax from donee when the donor was not available was held to be an unreasonable restriction as under the Act donee had no right to notice, representation or for appeal.

Under the Income-Tax Act,1961 the tax payable by nonresident assessees who are assessed to tax is recovered from their agents residing in India. In such a case though the income is really that of the non-resident, the liability to pay the tax falls on the agent who is assessed as the representative assessee. In A.A.D. Marzook v. C.I.T.,Madras,[115] the constitutionality of such a provision was upheld as the court found that

114. A.I.R.(1963) Cal.127,131;(B.N.Banerjee,J.). Here donar had left India. A contrary view was taken in Krishna Rao. v. G.T.O.,A.I.R.(1970) A.P.126,137

115. A.I.R.(1958) Mad.1. The case arose under S.43 of Income Tax Act, 1922 which was the corresponding provision. An earlier case regarding challenge as to mode of recovery is Jyoti Sarup v. Board of Revenue, Uttar Pradesh,A.I.R. (1953) All.25,29.

the agent could recoup himself of the amount paid by way of tax and in fact there was no real hardship.

Certain other modes of recovery of tax are provisions for advance payment of tax and for deduction of tax at the source.[116] Usually where an assessee commits default in payment of tax, penalty proceedings are taken. Penalty proceedings are quasi criminal in nature and principles of natural justice have to be complied with in imposing penalty.[117] Generally in a case of mere default a penalty not exceeding the amount of tax is possible.

Lastly come the provisions for checking the evasion[118] of tax by an assessee. The courts have "viewed with tolerance and even benignity the use by tax payers of various resorts to keep their income or part of it outside the strict words of the Act, however clearly it may be within its spirit."[119] Measures generally adopted for checking the evasion of tax liability

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116. See Section 190 of Income Tax Act,1961. cf.Radheshyam v. Union of India,A.I.R.(1960) Bom.353,364.

117. cf.C.I.T.West Bengal v. Anwar Ali,A.I.R.(1970) S.C.1782,1784; Chaturbhai M.Patel v. Union of India,A.I.R.(1960) S.C.424, 430.

118. The law is that avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. Effectiveness of the device depends not upon considerations of morality.C.I.T.,Gujarat v.A.Raman & Co.,A.I.R.(1968) S.C.49,53.The term"avoid" is also sometimes used to mean"escaped assessment" on account of concealment or even oversight. cf. Mansukhlal v. C.I.T., Bombay,A.I.R.(1969) S.C.835,839.

119 Julius Stone,Social Dimensions Of Law And Justice(1966), p.325.Whether the courts will take a firm attitude against such measures by tax payers" must necessarily turn to some extent upon their attitude to the social policy behind taxation either in general or in relation to some particular measure" Dennis Lloyd, Public Policy(London, (1953) p.11.

are provisions for reassessment, provisions which nullify the effect of transactions entered into with an intention to escape the liability altogether or minimise the burden and provisions for imposing penalty when evasion of tax has been detected. Such provisions, because of their beneficial effect on the revenue and the public may be termed generally in the interest of general public within the meaning of Art.19 (5) & (6).

Regarding provisions for reassessment the statute should circumstribe the discretion of the authority with circumstances under which he can initiate reassessment proceedings.[120] Since a citizen has a fundamental right not to be harassed in connection with a charge of non -payment of tax due to the revenue by concealment or otherwise at the whims and fancies of officers of revenue, the power conferred to reopen closed assessments[121] should be able to withstand the challenge under Art.19 as a reasonable restriction in the interests of general public. So also, generally such provisions contain a time limit within which proceedings have to be initiated. This requirement as to time limit is also a condition for test-

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120.Under S.147 of Income Tax Act,1961 the officer should have reason to believe that income had escaped assessment owing to the failure or omission on the part of the assessee, or on information in his possession he should have reason to believe that income has escaped assessment before issuing a notice.~~The existance of this reasonable belief that income has escaped assessment before issuing a notice~~ The existence of this reasonable belief is a condition precedent which the court can examine See.C.I.T.,Gujarat v. A.Raman & Co.,A.I.R.(1968) S.C.49,52.

121. An order of "nil" assessment is not a closer assessment. Madras v. Batcha & Co.,A.I.R.(1967) S.C.1537.

ing reasonableness of the provision under Art.19.[122] An assessee could not reasonably be excepted to keep his account books for ever. Further, the procedure for assessment of tax on reopening of assessment should be normally similar to that of the original assessment and the right of appeal should be available as if that was an original order of assessment[123] in order to satisfy the test of procedural reasonableness under Art.19.

The provisions to check avoidance of tax liability have often been challenged under Art.19. In Balaji v. I.T.O., Akola,[124] Section 16(3) (a)(i) and (ii) of Income Tax Act,1922 which provided that income of a wife and that of minor children admitted to the benefits of a partnership should be added to that of the assessee for the purpose of taxation, was challenged as an unreasonable restriction as the assessee had to pay

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122.But see Kotkapura Bus Service v. Excise & Taxation Officer, A.I.R.(1964) Punj.438,442 where a contrary view was upheld. On the facts of the case the reopening of assessment was within 5 years and as such the case may not be a direct authority for the proposition of law it lays down. But it is beyond doubt that statutes of limitation do not apply against state unless expressly provided for. If so, can it not be argued that the liability to pay the tax persists and the state may enforce it at any time.

123.Rashid & Son v. I.T.O., A.I.R.(1964) S.C.1190(held that procedures for assessment under Ss.34 and 34(1-A) of Indian Income Tax Act,1922 were same).

124.A.I.R.(1962) S.C.123; Srinivasan v.C.I.T.,Madras,A.I.R.(1967) S.C.517,518. A rule providing for keeping accounts of hour to hour of the quantity of ground nut used for extracting oil by mill owners was struck down in Seshaiah v. Andhra Pradesh,(1972) Tax L.R.1706(A.P.).

~~124xAxIxRx(1962)xSx~~

tax for the income of his wife and children. Upholding the validity of the provision the Supreme Court held that creation of such partnerships was a usual mode employed to avoid income tax and that the assessee could recoup himself from the income of his wife and children.

There are provisions in taxing statutes which authorise the officers of the revenue to conduct inspection and search of any premises, vehicle etc., owned or occupied by an assessee and to seize documents, unaccounted money or goods. Such conferment of drastic power though is a serious invasion upon the rights, privacy and freedom of the tax payer and invariably distrusted by him,[125] has been found to be really a necessary power to be conferred on revenue authorities to check the evasion of tax. That being so, the provisions have to be examined to see whether they impose reasonable restrictions under Art.19(5) and (6). If such powers of search and seizure are found to be necessary to check the widespread evasion of tax in the country the only question which remains is how it can be made a reasonable restriction under Art.19 (5) and (6). Dealing with the problem we have to bear in mind that such powers of search and seizure have been treated as a necessary concomitant in detection of crimes under the Criminal procedure Code, the difference being that in such cases

125 "Many sleeping lions,if not passions, are roused and the old forgotten war cries of the eighteenth century battle of Entick. v.Carrington,(1765) 19 State Tr.1029, came roaring through the corridors of history to face the jaded jurisprudence of the 20th Century to find it unresponsive.Prized freedoms, newly won then, have now after two centuries,became too old to defend themselves" P.B.Mukharji,J., inSurajmull Nagarmull v. C.I.T,A.I.R.(1961) Cal.578,581.But the courts still readily step in where abuse of power is shown.I.T.O.Meerut v.Seth Brothers, A.I.R.(1970) S.C.292,297.

the power is exercised or controlled by judicial magistrates. But the fact that such powers are conferred on high authorities of revenue cannot in the present context make much difference. So the tendency of the judicial decisions, while such provisions in taxation statutes are challenged, is to see whether the same safeguards or comparable safeguards as are available under the Criminal Procedure Code are available to the person whose premises are searched. The recent Supreme Court decision in Pooran Mal v. Director of Inspection,[126] where the constitutional validity of Ss.132 and 132A of Income Tax Act,1961 was challenged is illustrative. Upholding the validity of the impugned provisions the Court pointed out the following safeguards.[127] Firstly, the power is vested in the highest officers of the department.[128] Secondly, the power can be exercised only on the reasonable belief that books of accounts or documents have not been produced even after requisition or that even if such requisition is made such person would not produce such document or accounts or that any person is in possession of any money, bullion, jewellery etc., which represent wholly or partly his undisclosed income or property. Further the authority has to record reasons also. Thirdly, the authorisation to conduct the search cannot be issued to an officer below the rank of an income tax officer. Fourthly, the authorisation should specify the mode of search to be conducted as specified in the section itself. Fifthly, if money or bullion is seized,

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126. A.I.R.(1974) S.C.348.
127. Ibid at 356.
128. Namely on director of inspection and commissioners of income tax.

the income tax officer had to make a summary enquiry within ninety days to decide how much of it should be retained by him to cover any estimated tax liability and the rest had to be returned. If books of accounts are seized, they can be retained only for a maximum period of 180 days. Sixthly, if such person furnishes adequate security any money seized should be immediately returned. Lastly, the provisions of Code of Criminal Procedure relating to search and seizure apply to searches under the Income Tax Act.

The Supreme Court has also upheld the validity of[129] provisions in taxing statutes authorising taxation officers to conduct search after recording reasons on the ground that such provisions are similar to S.165 of Code of Criminal Procedure, which authorises ~~magist~~ the police officers to conduct searches without a warrant from a magistrate in cases where there was not sufficient time to obtain one.

The phrase that the officer should have"reason to suspect" that a person was attempting to evade tax was held to be sufficient guideline in Board of Revenue, Madras v. R.S. Jhaver.[130] It was also held in the above case that such power

129.See Board of Revenue v.R.S.Jhaver,A.I.R.(1968)S.C.59,66.

130.A.I.R.(1968) S.C.59,66; Nathulal Fatehpuria v.Rajasthan,A.I.R.(1968) Raj.151,156. A view expressed by Mysore High Court in Abdul Wahab & Co. v.Asst.Commr.Commercial Taxes, A.I.R.(1968) Mys.100,103 was that mere suspicion was too slender a basis for the exercise of too drastic a power, as the law did not provide for recording reasons.

should ordinarily be not invested with officers of too low status.[131] This aspect could be tested only when compared with the number of persons covered by the Act and where such number is too large the courts could not normally insist officers of high rank alone to exercise the power. Other safeguards in this type of cases are provision to record reasons for the search,[132] and provision for specification, so far as possible, the nature of the thing or document to be searched.[133] Further

131. A.I.R.(1968) S.C.59,66. The assistant c.t.officer, inspector of revenue department and police sub inspector were held to be not officers of inferior status. See M.P.Kannan v. Kerala, A.I.R.(1966) Ker.143,146.

132. In Balwant Singh v. Director of Inspection, A.I.R.(1969) Del.91 it was held that such a provision was not mandatory. But in this case S.132 of Income Tax Act,1961 used the phrase of "reasonable belief", only upon which an officer could order search and this was held to provide an objective test for judicial scrutiny.

133. See Seth Gopikisan Agarwal v. R.N.Sen, A.I.R.(1967) S.C.1298. But the officer need not specify the exact thing or document. Durga Prasad v. Supt.(Prev.)Cent.Excise, A.I.R.(1966) S.C.1209,1216. Both cases arose under S.105 of Customs Act, 1962.

the officer conducting search has to record reasons[134] before ordering seizure of documents and such documents should be retained in possession only so far as they are necessary.[135]

A very usual provision found in sales tax legislation is the provision authorising the setting up of check posts and also to provide that goods shall not be transported across these barriers without the accompaniment of prescribed documents such as bill of sale, way bill and other declarations in prescribed forms. The officers at these check posts are authorised to inspect every vehicle passing through and also to detain and confiscate goods which do not conform to the prescribed conditions. Generally speaking, a requirement that carriers of goods should take the documents relating to the

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134. Nathulal Fatehpuria v. Rajasthan, A.I.R. (1968) Raj. 151, 160. (Here relief was given as the officer did not record any reason for seizure). See Chandrika Sao v. Bihar, A.I.R. (1967) S.C. 170, where it was held that the officer had to peruse documents to see whether it was held that the officer had to peruse documents to see whether they were liable for confiscation and then only he need record reasons and a person could not lawfully snatch away the documents while the officer was perusing them and later contend that the search was illegal as he did not record any reason.

135. Regarding illegal searches, a person had a right to obstruct such searches. He can also come to a court of law and get redress. But if such a search is conducted and documents are illegally seized and were allowed to be made use of for further proceedings, the law is that an assessment based on account books seized illegally is not invalid. cf. Annamalai Chettiar & Co. v. Dpty. Commercial Tax Officer, (1965) 26 S.T.C. 687 (Madras). See also Pooran Mal v. Director of Inspection, A.I.R. (1974) S.C. 348, 361.

transport, purchase or ownership of the goods to satisfy the revenue authorities that such transport of goods did not involve any evasion of legitimate taxation could not be said to affect a citizen's fundamental rights under Articles 19(1) (f) and (g). But the cases which have arisen under these provisions relate not to inspection at check posts but to provisions relating to confiscation of goods at the check posts. The Mysore High Court in Venkatachalapathi v. C.T. Inspector,[136] struck down Section 28-A of Mysore Sales Tax Act,1957 as ultra vires a Art.19. It was held that the procedure prescribed for ordering confiscation of goods did not satisfy the test of reasonableness under Art.19 of the Constitution.[137] The Andhra Pradesh High Court in K.S.Papanna v.Dpty.C.T.O.,[138] upheld Ss.28 of A.P.Sales Tax Act,1957 as confiscation of goods could be ordered only on the basis of enquiry and finding that the goods had evaded sales tax. The Kerala High Court in a recent decision Yogesh

136. (1965) 16 S.T.C.894 (Mys). It was held that the power to confiscate goods evading tax was incidental to the power to impose tax.

137. No provision for any detailed enquiry and the proof was only through prescribed means and other methods of proof were excluded.

138. (1967) 19 S.T.C.506(A.P.) followed in Kalangi Krishna Murty & Co. v.C.T.O.,Guntur,(1968)22 S.T.C.540(A.P.).

Trading Co.Kotachery v. Intelligence Officer,[139] held S.29 of Kerala General Sales Tax Act,1963 ultra vires Act 19.Gopalan Nambiar, J.,[140] speaking for the Court observed that the provision amply brought out the fact that unless the owner travelled with the goods, the notice provided was not likely to reach him in time to avoid the catastrophe of confiscation. Since the state had power to check the evasion of tax, no citizen can claim a fundamental right to property or to conduct trade cheating the public and revenue. So the reasonableness of such a provision should afford an opportunity to the person conerned who claims to be the owner[141] of the goods to explain and satisfy that no tax is in fact evaded. If that much is

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139. A.I.R.(1970) Ker.218(F.B.) (The section was mainly struck down under Art.301 of the Constitution).

140. Ibid at pp.227-228. It was true that there was some disparity between the Act and the Rules. But S.29(4) provided for an opportunity to be given to the Owner and no rule framed can whittle this right down. It is submitted that the Court need only have struck down the rules and strictly enforced the right to hearing before confiscation.

141. The Section 29(4) of Kerala Act reads" Owner if ascertainable". The Court found fault with this provision also.If owner is not ascertainable how can be be given an opportunity to explain that the goods have not evaded tax due. If there is an owner he would come to know about detention of his goods and can come forward claiming them.

satisfied the court is not permitted to examine what is actually done under the statute. It is well settled that in such cases the administrative action need be struck down and not the statutory provision.[142]

Another provision of law calculated to deal with[143] unaccounted money provided for acquisition of immovable property when transferred for an under value was upheld under[144] Art.19 read with Art.31C.

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142. cf. K.S.Papanna v.Deputy C.T.O.,(1967) 19 S.T.C.506 where though the statutory provision was upheld the particular administrative action was struck down.

143. Chapter XXA of Income Tax Act 1961.

144. Mahavir Metal Works v. Union of India,A.I.R.(1974) Del.73.

PART FOUR

INTERSTATE COMMERCE AND TAXATION.

CHAPTER XIV

FREEDOM OF TRADE AND COMMERCE AND TAXATION.

Introductory

The power to regulate inter state commerce non-discriminately," to break down and to eliminate barriers to trade among the States"[1] is a necessary power of the central government in a federation.[2] The achievement of economic union, of a single market, while obviously contributing to essential united defence improves material peace-time welfare.[3] In the absence of such a power "local interests exerting powerful influences in state legislatures would, in the long run, prefer home industries over those that are out-of state, establish tarrif barriers, or employ other means tending to Balkanize the nation into hostile trade areas".[4] Since the elimination of state tarrif barriers was one of the chief motives[5] in the formation of federal unions, the question arises what is a trade barrier. A trade barrier may be defined as one which operates in a nation of many territorial units usually called states to the disadvantage of persons, products

1. Eugene V.Rostow, The Sovereign Prerogative: The Supreme Court and The Quest For Law(1962),p.302.
2. See Marshall, C.J., in Brown v.Maryland,(19827) 12 Wheat. 419.445.
3. Bowie and Friedrich, Studies In Federalism(1954),p.297
4. William O.Douglas, From Marshall to Mukherjea(Tagore Law Lectures,(1956) p.169.
5. The Federalist (Modern Library,New York) No.s7 and 13 at pp.37,78; Lord Wright in James v.Commonwealth,(1936) A.C. 578,630."The idea starts with the admitted fact that federation in Australia, was intended(inter alia) to abolish the frontiers between the different States and create one Australia".

or services coming from sister states to the advantage of local residents, products or enterprises.[6]

The federations of the world have tried to achieve this object through different methods. The first mode is to confer the power to regulate inter state commerce on the federal government and to deny such power to the regional governments. In U.S.A., the Constitution confers power upon the Congress " to regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes".[7] These sixteen words, generally known as the" commerce clause", as such, do not deal with any of the rights of the citizen to do inter state business. In U.S.A., the states are not wholly powerless to regulate inter state business.[8] The Canadian Constitution[9] is another example of this type of commerce clause.[10] The courts have given a very narrow interpretation to the words' trade and commerce' and the extent of the power exercised by the federal legislature is comparatively very

6. See Paul T.Truitt, "Inter-State Barriers in the United States" (1941) 8 Law And Cont.Problems, 207,208.
7. Art.1, S.8 Cl.3 of the U.S.Constitution. The Congress is competent to regulate every activity, whether regarded as commerce or not, if it exerts a substantial effect on inter state commerce. Jackson, J., in Wickard v. Filburn,(1942) 317 U.S.111, 125; Stone, C.J., in United States v. Wrightwood Dairy Co., (1942) 315 U.S.110,119.
8. The courts examine "whether the matter to be regulated demanded a nationally uniform system" and if the answer is in the negative the states may regulate it.See Cooley v. Board of Wardens,(1851) 53 U.S.299; Southern Pacific Co. v. Arizona,(1945) 325 U.S.761.
9. See S.91(2) of the B.N.A.Act,1867
10. See W.P.M.Kennedy, "The Interpretation of The British North America Act" (1944) 8 Cam.L.J.146.
11. See the entry 8 of the Federal List and IV Schedule of the Constitution which gives the power to regulate trade and commerce to Federal Legislature.

limited in Canada.[11] In Asia, Malayesia and in Africa, Nigeria[12] have adopted this type of commerce clauses. A second mode of providing for free commerce is to guarantee the freedom of commerce by the Constitution itself.The Constitution of Australia[13] is an example of this type. In such a case the power of both the[14] federal and the state legislatures to inferfere with the right[15] of citizens to engage in inter state activities, is restricted. The Australian Commerce clause has played only comparatively insignificant role[16] in contrast to its counterpart in U.S.A.

Scope of Freedom of Trade and Commerce

The framers of the Constitution of India had these two examples before them in addition to the provisions contained

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11. See the entry 8 of the Federal List and IV Schedule of the Constitution which gives the power to regulate trade and commerce to Federal Legislature.
12. See S.77 of the Constitution of Nigeria,1963.
13. S.92 provides" On the imposition of uniform duties of Customs, trade commerce and intercourse among the States, whether by means of internal carriage or ocean navigation shall be absolutely free".
14. James v.Commonwealth,(1936) A.C.578,633.
15. Even laws dealing with nationalization come within the purview of the right. Commonwealth v. Bank of N.S.Wales, (1950) A.C.235.
16. See K.H.Bailey,"Fifty Years of The Australian Constitution" (1951) 25 A.L.J. 314,322-323. Further, in Australia the concept of commerce seems to be confined to the movement of something from one states to another.See Ross Anderson, "Freedom of Inter State Trade: Essence,Incidence and Device under Section 92 of The Constitution"(1959) 33 A.L.J.,294; P.H.Lane,"Trade and Commerce Power' Constitution S.51(1)" (1960) 34 A.L.J.99,106.

in S.297 of the Government of India Act,1935.[17] The scheme of Part XIII of the Constitution seems to be a synthesis of the commerce clauses of the United States and Australian Constitutions. As in Australia(S.92) the general freedom of commerce is declared by Art.301 as "subject to the other provisions of this part, trade, commerce and intercourse[18] throughout the territory of India shall be free".[19] Art.302 which gives the Central Legislature power to impose restrictions in the public interest, it is submitted, embodies the law in U.S.A, under the commerce clause. But the courts have permitted[20] parliament to delegate the power of regulation under Art.302 to the executive governments of the states and this device has undermined much of the efficacy of a provision like

17. The provisions of the Government of India Act,1935 were singular in the sense that the federal legislature possessed no power to regulate trade and commerce within the country. S.297 prohibited the provinces from restricting the entry into or export from the provinces of goods by virtue of any entry relating to trade and commerce and also prohibited the levy of any discriminatory tax on incoming goods from other provinces.
18. It is submitted that apart from this, Part XIII has no resemblance to the Australian Constitution and the heavy reliance on Australian law by our courts is clearly misconceived . See for example Shah, J., in Dist.Collector, Hyderabad v.Ibrahim & Co.,A.I.R.(1970) S.C.1275,1279
19. Art.302 reads"Parliament may by law impose such restrictions on the freedom of trade, commerce or intercourse between one state and another or within any part of the territory of India as may be required in the public interest".It has been held that prevention of evasion of tax is a measure in the public interest in Tamil Nadu v.Sita-lakshmi Mills, A.I.R.(1974) S.C.1505,1509.
20. See M.A.Rasheed v. Kerala,A.I.R.(1974) S.C.2249,2255; Chinta Lingam v. Government of India,A.I.R.(1971) S.C.474, 476.

Art.302 resulting in inaction by Parliament and also over-active erections of trade barriers by states under such delegated power. Such delegation of the very powersto the states which the constitution has withheld from them is clearly unconstitutional. Neither the Central Legislature nor the state legislatures should give preference to one state over another or make any discrimination between one state and another except[21] in a case where the Central Legislature has made a law to meet situation of scarcity[22] in any part of the country. The states are permitted to impose reasonable restrictions in the interests of general public, on the freedom of trade, commerce or intercourse through legislative action with the sanction of the President of India obtained for the introduction of such a bill in the state legislature.[23]

21. See Art.303 (1)."(1) Notwithstanding anything in Article 302, neither Parliament nor the Legislature of a State shall have power to make any law 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, by virtue of any entry relating to trade and commerce in any of the Lists in the Seventh Schedule".
22. See Art.303(2). "Nothing in clause(1) shall prevent Parliament from making any law giving, or authorising the giving of, any preference or making or authorising the making of, any discrimination if it is declared by such law that it is necessary to do so for the purpose of dealing with a situation arising from scarcity of goods in any part of the territory of India".
23. See Art.304(b),"Notwithstanding anything in Art.301 or Article 303, the Legislature of a State may by law.....(b) impose such reasonable restrictions on the freedom of trade, commerce or intercourse with or within that State as may be required in the public interest.
Provided that no bill or amendment for the purposes of clause(b) shall be introduced or moved in the Legislature of a State without the previous sanction of the President".

Art.303(1) does not control the power of taxation as the article specifically refers only to the legislative power relating to trade and commerce.[24] The article is similar in words to S.99 of the Australian Constitution and there it has been held[25] that S.99 applied only to laws which could be made under the powers conferred upon Parliament to make laws with respect to trade and commerce under S.51(1) of the Australian Constitution. The terms 'preference' and 'discrimination' are the two sides of the same coin because where a thing is being preferred it can be done only by discriminating against another. The preference may be any "tangible advantage"[26] or even "impediment"[27] in the course of trade or commercial operations. S.8 of the Central Sales Tax Act,1956 dealing with the rate of sales tax on inter-state sales, has been challenged under Art.303 of the Constitution unsuccessfully. S.8 of the Central Sales Tax Act prescribes different rates of taxes, namely, (a) 3% where the sale is made to a government or when

24. See Bhola Prasad v. R.(1942) F.C.R.17. In Madras v. Nataraja Mudaliar ,A.I.R.(1969) S.C.147,156 Shah, J., left the question open as being academic.
25. Morgan v.Commonwealth,(1947) 74 C.L.R. 421,455.
26 Dixon, J., in Crowe v.Commonwealth,(1935) 54 C.L.R.69,92
27. Starke, J., in Crowe v.Commonwealth(1935) 54 C.L.R.69,86.

the sale of certain goods is made to a registered dealer,(b) the rate of tax prevailing in the appropriate state where the sale is made by a registered dealer of declared goods, and(c) 10% or the rate in the appropriate state which ever is higher when sale of goods otherthan declared goods, is made by a registered dealer. It can be seen that the rates prevailing in the state of the seller are made the rates of tax under the Act in certain cases.This was challenged as a provision giving or authorising the giving of preference to one state over another within the meaning of Art.303(1) in Madras v. Nataraja Mudaliar.[28] The Court rejected the contention as the prevalence of different rates in various states did not amount to giving preference to one over another. This contention was again raised before the Supreme Court in Tamil Nadu v. Sitalakshmi,[29] and the Court held that the rates had been so fixed to discourage sales to non-registered dealers.The maximum that could be said about S.8 of the Act is that it may enable a state to decrease the rate of tax and help its goods to be sold more in different states. But that is not preference or discrimination against any goods of other states.

28. A.I.R.(1969) S.C.147.

29. A.I.R.(1974) S.C.1505,1509.

In Automobile Transport Ltd. v. Rajasthan,[30] Subba Rao, J., observed that reference to Art.303 in the opening non-obstante clause of Art.304 was irrelevant. It follows that under Art.304(b) if President assents to a bill, the state legislature can impose even a discriminatory restriction on the freedom of commerce provided that it is not unreasonable. Such laws are subject to judicial scrutiny regarding reasonableness and public interest. The purpose behind the insistence on presidential sanction is to ensure uniformity among state laws. This is a deviation from the law available in the United States of America[31] as in India a limited field is expressly left for state regulation and the authority to decide whether such field is amenable to state regulation is left wholly to the federal executive. The states are prohibited from imposing taxes on goods imported from the other states so as to discriminate between goods so imported and goods produced or manufactured inside the state.[32]

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30. A.I.R.(1962) S.C.1406,1434.
31. In U.S.A., only the Federal Legislature can authorise such state regulation. See In Re Rahrer, (1891) 140 U.S. 545 where a law of Congress provided that all shipments of liquor into any state were to be subject to state laws and such delegation was upheld.
32. Art.304(1) "Notwithstanding anything in Article 301 or Article 301 or Article 303, the Legislature of a State may by law(a) impose on goods imported from other States or the Union territories any tax to which similar goods manufatured or produced in that State are subject,so, however, as not to discriminate between goods so imported and goods so manufactured or produced......".

Art.305 provides that nothing in Arts.301 or 303 shall affect the provisions of any existing law except in so far as President may otherwise direct and thus protects all pre-constitutional laws from the operation of Articles 301 and 303. In Bangalore Woollen,Cotton and Silk Mills Co. v. Corporation of Bangalore,[33] an octroi duty was levied by the respondent Corporation in 1954, under the Bangalore Municipal Corporation Act which was a pre-constitutional legislation of 1949. Rejecting the contention of the appellant,it was held that all the articles on which octroi was leviable were intended to be included in the parent statute itself and that there was no alteration or modification of the existing law in 1954 so as to divest the protection under Art.305. This decision appears to lay down the law that where a statute authorises the levy of a tax or a restriction, it would not matter even if such levy or restriction was imposed after the Constitution.[34] But the position of law is not so simple as it appears and the decision in Kalyani Stores v. Orissa,[35] may be mentioned here. Under the Bihar and Orissa Excise Act,1915 the duty in respect of imported foreign liquor at the rate

33. A.I.R.(1962) S.C.562,566-567; See also Kuttikeya v. Madras A.I.R.(1954) Mad.621,631 where Venkatarama Aiyar, J., held that it would not matter even if a pre-constitutional law was extended to a new area after the Constitution.
34. See Wanchoo, C.J., in Surajmal v.Rajasthan, A.I.R.(1954) Raj.260.
35. A.I.R.(1966) S.C.1686. The decision in Bangalore Woolen Cotton Mills v. Bangalore Corporation,was distinguished as one which turned entirely upon the interpretation of the special provisions of the Bangalore Municipal Corporation Act. See A.I.R.(1966) S.C.1686,1692.

of Rs.40/- was increased to Rs.70/- after the Constitution.The Court by a majority[36] held that the increase of levy was hit by Art.301.[37] The Court held that the pre-constitutional rate would be saved by virtue of Art.305. It is really difficult to understand the difference between the imposition of a duty for the first time and the increase of the rate of an existing duty.A power to impose a tax generally includes a power to increase the rate of tax already imposed. If the Court had held that the power to impose the duty under Bihar and Orissa Excise Act had expired by its use once and could not be exercised again,[38] that could have been a more valid ground.But here the majority upheld the validity of the law both under Articles 305 and 372 and also of the prior levy while invalidating the increase in the levy.[39] Hidayatullah, J., who dissented[40] pointed out that unlike Article 276 Art.305 was not concerned with increase of the rate of tax as "what was done under its authority in the past and what is being done today is equally valid".

The provision contained in Art.305 has been made use

36.Gajendragadkar, C.J., Wanchoo, Shah and Sikri, JJ.
37.Ibid at 1692,. It is doubtful whether the view of the majority was that the levy was invalid under Art.301 or under Art.304. This difficulty arises from a line of interpretation put on the provisions in Part XII by the Supreme Court, discussed infra.
38.This may happen either because the power could be exercised only once or because the authority becomes functus officio or self effecive after the use of the power once.
39.The difficulty in reconciling these two decisions is evident from the error committed by the Kerala High Court in Abdul Kadir v. Kerala , that the decision in Kalyani x. Stores v. Orissa, was that, under Art.304(a) a state could levy a tax on goods coming from outside only if similar goods are produced or manufactured inside the state.
40.SeeA.I.R.(1966) S.C.1686,1696.

of in upholding taxes imposed on goods from sister states in Chobe v. Palnitkar[41]. It is submitted that the decision is incorrect as Article 305 refers only to Arts 301 and 303 and not to Article 304. Since no import duty could be levied on indigenous goods the levy was hit by Art.304(a). The view that Art.305 was enacted not to save existing discriminatory taxes or tax barriers is evident from the exclusion of Art.304 from the operation of Art.305. Article 303 refers to discrimination and preferences by Parliament and state legislatures other than by way of taxation[42] and by excluding Art.304 from the operation of Art.305 the Constitution makers intended to do away with tax barriers wholly and to preserve other restrictions till federal scrutiny is done. This view finds support from the fact that S.297 of the Government of India Act, 1935 also prohibited discriminatory taxes on out of state goods. It has been held that Art.305 would not protect[43] the extension of an existing law to a new area after the commencement of the Constitution[44]. In Mysore v. Sanjeeviah,

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41. A.I.R.(1954) Hyd.207(a duty on sweets, broughts from Lucknow, imposed under Hyderabad Customs Act.).
42. That is "by virtue of any entry relating to trade and commerce in any of the Lists in the Seventh Schedule". It is clear that such entries could not mean entries dealing with taxation.
43. Vallabhadas Kanji v. S.T.Officer, A.I.R.(1963) Ker.202,209.
44. A.I.R.(1967) S.C.1189,1192.

it has been held that rules framed after the commencement of the Constitution under a pre-constitutional law would not get the protection of Art.305. Hence it might be said that the present position of law is that though all existing laws are protected by Art.305 any fresh action taken under such laws is not protected.

The only questions taken up for consideration in this chapter are(1) whether a tax could be a restriction on the aforesaid freedom apart from the provisions under Article 304(a)[45] and (2) under what circumstances could ~~be~~ a tax be termed a hindrance to or as interfering with the freedom of trade, commerce or intercourse.

Before answering the above questions it would be pertinent to note the line of interpretation taken by the Supreme Court of India on Part XIII of the Indian Constitution. Though[46] Art.301 declares freedom of trade, commerce and intercourse, both inter-state and intra-state, subject to the other

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45. The problem created by tax on inter-state sales and purchases of goods is dealt with separately.

46. According to Marshall, C.J.,"Commerce, undoubtedly is traffic, but it is something more; it is intercourse. It describes the commercial intercourse between nations, and parts of nations in all its branches, and is regulated by prescribing rules for carrying on that intercourse" in Gibbons v. Ogden,(1824)9 Wheat.1,189. In India whether the term includes movement of persons and telephonic communications was left open by S.K.Das , J., in Automobile Tr.v. Rajasthan,(1962) S.C.1406.

[47] provisions of this part, namely, Part XIII of the Constitution of India, the Supreme Court of India has always interpreted Art.301 as the main clause which confers the freedom(just as in Australia) and Arts.302 to 305 as exceptions to that freedom. For example, in Atiabari Tea Co . Assam,[48] the Court found the tax to be violative of Art,301, and could not be upheld under Art.304(b). Similarly in Kalyani Stores v. Orissa[49] it was held that the increase in the levy violated Art.302, 303 and 304. Some defective drafting has also crept into the provisions of Part XIII.[50] For example, though Art.301 is expressly made subject to other provisions, Art.301 is referred to in the non-obstante clause of Art.304. Again the Court has always treated Art.304 as prospective[51] and as enabling. Since

47. See Atiabari Tea Co. v. Assam, A.I.R. (1961) S.C.232,249. For criticism see H.M.Seervai, Constitutional Law of India(1967),P

48. A.I.R. (1961) S.C.232,254.

49. A.I.R. (1966) S.C.1686,1692(Shah,J.) Hidayatullah, J., who dissented observed: "Art,304(a) imposed no ban but lifts the ban imposed by Articles 301 and 303 subject to one condition". Ibid at 1696. All those words,'ban' etc., appear to make the state's power to legislate, to tax etc., the highest good and not the economic freedom and unity of the nation.

50. Ohter examples are; reference to Art.302 in Art.303 because Art.302 does not relate to state legislatures. See Gajendragadkar,J., in Atiabari Tea Co. v. Assam, A.I.R. (1961) S.C. 232,251 and reference to Art.303 in Art.304 in relation to Art.304(a) See Subba Rao, J., in Automobile Tr. v. Rajasthan, A.I.R. (1962) S.C.1406,1434.

51. See Shah J., in Kalyani Stores v. Orissa, A.I.R. (1966) S.C. 1686,1691 and HidyatNullah, J. at 1696.

legislative power flows from the entries in the legislative lists, how Art.304 could be viewed as an enabling provision is difficult to understand. By the term prospective also, what was intended is also not clear, since it is no new provision and Section 297(1)(b) of Government of India Act,1935 provided for the same.

Article 304(a) And Taxation.

Article 304(a) being a provision which deals specifically with taxation, a brief discussion of its scope is necessary. It places goods imported from sister states on a par with similar goods manufactured or produced within the state in regard to state taxation within the allocated field.[52] The object of Art.304(a) was to limit the power of taxation by states so as to prevent discrimination against imported goods by imposing taxes on such goods at a higher rate than is borne by indigenous goods. The tax referred to in Art.304 (a) is a "tax on goods". The exact connotation of the words has not been hitherto considered by the courts. But this provision has been expressly referred to a tax on sale of goods,[53] an excise duty[54] and may cover octroi tax on carriage of goods,[55] but a toll[56] or a tax on vehiclesmay[57] not be called so, even though

52. S.K.Das,J., in Automobile Transport Ltd. v.Rajasthan, A.I.R. (1962) S.C.1406,1418.
53. See Hajee Abdul Shukoor v. Madras, A.I.R.(1964) S.C.1729.
54. See Kalyani Stores v. Orissa, A.I.R.(1966) S.C.1689.
55. See Seervai, Constitutional Law of India(1967),p.1001.
56. But see Girdharilal Anand v. Jammu & Kashmir,A.I.R.(1969) J.& K.113,120 for the view that toll is a "tax on goods".
57. In such cases Art.301 will have to be invoked as Art.303 does not relate to taxation.

it is 'verbal' law making ie. tax has to be on 'goods' so tax on vehicle is not covered. Even if such goods are taxed alike the law may be bad for discrimination if some advantage is given to domestic goods over out of state goods.

Patanjali Sastri,C.J., in Bombay v. United Motors,[58] observed that the commercial unity of India was made to give way before the state power of imposing "any" non discriminatory tax on goods imported from sister states. The statement of law, it is submitted, is too wide. The fact that home made goods are subject to similar tax burden is a prima facie proof of non discrimination.[59] At one time it was thought that ~~iw~~ it was not possible to tax an imported article of goods unless similar goods are produced or manufactured inside the state. It was thought that such absence of indigenous goods would result in arbitrary exercise of taxation and consequent destruction of the trade of such imported commodity. In Kalyani Stores v. Orissa,[60] Shah J., observed " As no foreign liquor is produced or manufactured in the State of Orissa the power to legislate given by Art.304 is not available and the restriction which

58. A.I.R.(1953) S.C.252.257.
59. Bombay v. R.M.D.C.,A.I.R.(1956) Bom.1,16.
60. A.I.R.(1966) S.C.1686,1691. The decision proceeded on the ground that under Entry 51, List II of Seventh Schedule to the Constitution of India no countervailing duty could be imposed if no such goods are produced locally and that it was a restriction on Art.301 being an excise duty.

id declared on the freedom of trade, commerce or intercourse by Art.304 of the Constitution remains unfettered". This observation was relied upon by the Kerala High Court in invalidating a levy of luxury tax on tobacco under Art.304(a) as no tobacco was manufactured locally. On appeal in Kerala v. Abdul Kadir,[61] the Supreme Court held that the correct approach was to see whether the impugned tax impeded the free flow of commerce under Art.301 and only if the court comes to the conclusion that it infringed Art.301, the question whether it is saved by Art.304(a) as a non-discriminatory tax could arise. The decision in Kalyani Stores case was explained away as a non-application of Art.304(a) as there was no indigenous production of "foreign liquor" The reasoning, it is submitted, takes away much of the rigour of Art.304(a) as an independent provision of law. For example, according to the view of the Supreme Court even if a state imposed a discriminatory tax on imported goods, the courts will have to see whether such tax infringed the freedom under Art.301 and only after such a finding it could be examined under Art.304(a), instead of striking down such a levy as offending Art.304(a) itself.

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61. A.I.R.(1970) S.C.1912,1918 (Ramaswami, J.). See Satyanarayana Mahabir v. Assam, A.I.R.(1971) Ass.83. A sales tax on vanaspathi was challenged under Art.304(a) as no vanaspathi was manufactured inside the State. It was held that normally sales tax was not a restriction under Art.301 and hence no question of application of Art.304(a) did arise.

Moreover the Supreme Court's view that only if a tax offends the freedom under Art.301, an enquiry is needed whether it can be saved under Art.304(b), is a little confueing. If taken literaelly it would mean that a non-discriminatory tax saved under Art.304 (a) may be a hindrance under Art.301.

The problem still remains whether protection is necessary for goods coming from other states when similar goods are not manufactured inside the state. It is true that even though there are chances of hostile taxation of such goods, a blanket protection from every taxation is not warranted. Any heavy taxation of such goods should be examined by the courts under Art.301 to see whether it infringes the freedom of inter state trade and commerce. This has to be done objectively and not in a superficial way by labelling it as "direct or indirect" restriction.

The term" imported goods" in Art.304(a) would cover cases of goods brought by traders from other states for sale inside the state. So the term is wider than the term "inter-state sale". For example, if a businessman goes to another state, purchases goods there and brings it to the first state, or if a trader from one state takes his goods to another state and sells there, such transactions would not be interstate sales. But Art.304(a) would cover such cases as here the test is whether the goods are of local origin or out of state origin.

68.A.I.R.(1964) S.C.1086. Here the local sales tax law imposed a tax on imported tabacco only and was struck down.

The tax barriers erected by state may be evident as in the case of Machya Pradesh v. Bhailal Bhai,[62] or may be ingenious as in Mehtab Majid and Co. v. Madras.[63] In the later case the petitioner firm was a dealer in a tanned skins and hides obtained from inside and outside the State. S.5 of Madras General Sales Tax Act taxed skins and hides tanned or untanned at a single point. According to R.16 of Madras General Sales Tax (Turnover and Assessment) Rules, 1939 untanned hides were taxable at the point of last purchase within the State and tanned hides were taxable at the point of first purchase within the State. The said rule also provided that in the case of tanned hides such tax was not recoverable if tax had been paid within the State on them as untanned hides. This seemingly innocent provision resulted in great discrimination on dealers who imported tanned hides from outside the State[64] as tax on

62. A.I.R. (1964) S.C. 1006. Here the local sales tax a law imposed a tax on imported tobacco only and was struck down.

63. A.I.R. (1963) S.C. 928. An Article 32 petition. But if such taxation was not discriminatory vis-a-vis out of state goods, the tax will be upheld. In Henne ford v. Silas Mason Co., (1937) 300 U.S. 577 the state law imposed a tax on goods at the same rate if such goods were purchased in a market outside the state without paying sales tax there or paying a lesser rate. The tax was upheld even though its effect was to help dealers in the state to complete on an equal footing with out of state sellers.

64. Even if it was practically possible to get untanned hides from outside the State, the point of taxation was the last purchase within the State. Of course the matter is beside the point as goods imported were tanned hides and question was whether there was any discrimination with regard to tanned hides produced within the State so far as Art. 304(a) was concerned.

hides inside the State was on the price of the raw material and on those imported from outside was on the sale price of the finished product. The Court held the levy discriminatory and unconstitutional rejecting the contention that in order to attract Art.304 (a) the impost must be at the border, that is to say, when the goods enter or cross the border of a State.[65]

The question of reasonable classification not amounting to discrimination was argued as applicable in determining the scoops of Art.304(a). The contention was that in order to establish discrimination, circumstances and situations at the taxable point must be similar and the circumstances of hides or skins tanned within the state for which tax had been already paid constituted different conditions to form a separate class from tanned hides coming from outside the state which were not so similarly situated.[66] Repelling this contention, it was held that the similarity contemplated by Art.304(a) was in the nature of the quality and kind of the goods and not with respect to whether they were subject of a tax already or not.

In Haji Abdul Shukoor & Co v. Madras,[67] this defect was attempted to be rectified by providing a rate of tax of 20%

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65. See Ibid at 931.

66. A.I.R.(1963) S.C.928,932. In C.J.Jayaswal v. Gujarat, A.I.R. (1964) Guj.59 a vend fee per gallon to import varnish was struck down under Art.304(a).

67. A.I.R.(1964) S.C.1729,1733. In Madras v. Noor Mohamed & Co, A.I.R.(1970) Mad.494, 496 it was held that these decisions were applicable only in the context of a single point system of taxation and hence not applicable to an unlicensed dealer to whom the facility of single point levy was not available.

on the turnover of hides and skins purchased in the untanned condition from outside the State for the years 1955 to 1959 from the first seller inside the State. This was invalidated as the rate was higher because 3 piece per Rupee was the rate of tax for untanned hides. A later amendment in 1964 providing for the tax to be calculated on the purchase price of untanned skins and hides rectified this and was upheld in Appellate Asst.Commr. v. L.M.S.Sadak Tamby & Co.[68]

The decisions of the courts clearly show that in order to attract the operation of Art.304(a) the mere inconvenience caused to an out of state dealer was not sufficient. For example, in Rattan Lal & Co. v. Assessing Authority Patiala,[69] it was contended that though the rate of sales-tax was same as regards indigenous and imported goods, the imported goods were more expensive by reason of freight etc., and hence the burden of tax would be in effect heavier on such goods. It was held that Art.304(a) prohibited only differential rates of tax and the heavier burden was a consequence of advalorem tax being levied at a particular rate. In Madhya Pradesh v. Abdeali,[70] the State sales tax legislation had exempted hand-made footwears of the value below Rs.12.50 if sold by the

68.A.I.R.(1974) S.C.2344.

69.A.I.R.(1970) S.C.1742,1750(Hidayatullah, C.J.)An inspection fee levied only on goods imported from sister states would come under the mischief of the section as the term tax includes fee also. See for example a decision from U.S.A. Voight v. Wright,(1890) 141 U.S.62.

70.(1963) 1 S.C.A.287.

manufacturer himself. It was contended that the benefit of such exemption could be availed of only by manufacturers inside the State as it would be impossible for out of State manufacturers to bring their goods and sell it within the State. It is submitted that the decision is correct as the test is not whether an out of state manufacturer would be tempted to bring his goods a to a state but if he actually brings them he would be discriminated. The fact whether he would be tempted to bring such goods to a state would depend upon a variety of factors such as the sources of supply, place of consumption, existence of trade channels, the rates of freights, trade facilities etc.[71]

Art.304(a) will apply to a tax only if two conditions are satisfied, namely, the tax should be on goods coming from outside the state and such tax should be discriminatory in nature. It is true that the term tax on goods should be given a liberal interpretation and should not be construed in a narrow sense. Cases may arise where the tax levied is not on goods but discriminatory in nature and also where the tax levied is on goods which though not discriminatory

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71. See <u>Madras</u> v. <u>Nataraja Mudaliar</u>, A.I.R.(1969) S.C.147,156.
7 But the Court has also to see whether such conditions are really attached to errect a trade barrier.

is really a curtailment of the freedom of commerce. To illustrate the point, if dealers in out of state goods are required to take out licences on payment of a high fee,[72] or a tax is levied only on non-resident sellers,[73] it will be difficult to bring such cases under Art.304(a). That is to say, there can be certain areas of taxation beyond the reach of Art.304(a)[74] which could be used by the states to give preferential treatment to the goods of local origin over other goods. So in such cases recourse to Arts.301 or 304(b) becomes necessary and an inarticulate major premise that tax laws are dealt with exclusively by Art.304(a) is unwarranted.The statement only means that normally tax laws are not restrictions on the freedom of commerce but they can be and the Constitution should not be powerless to meet such contingencies.

Compensatory Taxes And Regulatory measures.

The position of law available in India is that a tax could be a hindrance on the freedom of commerce apart from the provisions of Art.304 (a).[75] The matter arose directly for

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72. See Robbins v. Shelby County Taxing Dist.,(1887) 120 U.S.489.
73. See Best & Co. v. Maxwell,(1940) 311 U.S.454.
74. Art.304(a) is more restricted in its ambit than its predecessor, namely, S.297(i) (b) of the Government of India Act, 1935 which prohibited the imposition of "any tax, cess, toll or due."
75. Seervai H.M.Constitutional Law of India,(1967)P.1002 holds the view that taxation for the purpose of revenue is beyond the scope of Part XIII of the Constitution.See by the same author "The Freedom of Trade and Commerce in the Indian Constitution: the Atiabari Case and a Tax"(1962) Cam.L.J.54, 81-82.

consideration in Atiabari Tea Co, v. Assam [76], and it was held that such tax laws should satisfy the conditions laid down in the proviso to Art.304(b), namely, previous assent of the President of India to the bill of the state legislature and that such tax should be a reasonable restriction in the public interest. In the above decision the validity of Assam Taxation (On Goods Carried by Road or Inland Water Ways) Act,1961 was challenged. The Act had imposed a tax on tea carried through Assam waters. The appellants before the Supreme Court were of two types. The first category grew tea in West Bengal and while sending it to the Port of Calcutta(situated in West Bengal) had to travel partly through rivers in Assam and the second category grew tea in Assam itself and sent it to the Port of Calcutta. Gajendragadkar, J., [77] who spoke on behalf of the majority formulated the test whether such restrictions directly and immediately restricted and impeded the free flow and movement of trade. [78]

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76. A.I.R.(1961) S.C.232.
77. Ibid at 245. Wanchoo and Das Gupta, JJ., along with him Shah, J., concurred and Sinha,C.J.,alone dissented.
78. This test, it is submitted, is taken from Australian constitutional law. See Wynes, Anstey Legislative Executive and Judicial Powers in Australia(1970),p.248. For the application of direct impact test See Emperor v. MunnaLal , A.I.R. (1942) All.156,163. The case arose under S.297 of Government of India Act, 1935. Dar, J., observed that measures of price control, collective marketing and expropriation of goods did not perse and as a matter of course interfere with free trade clause in the constitutional Act.

A tax on the transport or movement of goods solely on the basis that the goods are thus carried or transported was held to affect directly the freedom of trade contemplated by Ar.301.[79] Shah, J., who concurred with the majority view observed that movement was not an essential ingredient of trade and commerce. According to his lordship the guarantee is addressed to tariffs, licenses, marketing regulations, price control, nationalisation, economic or social planning, discriminatory tariffs, compulsory appropriation of goods, freezingand stand still orders and other orders affecting the freedom directly and immediately.[80] The conclusion of his lordship was that all taxation touching the above matters are hit by Art.301.

Sinha, C.J., who dissented rejected the extreme proposition that all types of taxes on trade or commerce would be hit by Art.301 as it would put too great an impediment on the power of states to tax.[81] According to his lordship, taxes might on the otherhand provide wherewithals to improve different

79. A.I.R.(1961) S.C.232,253.
80. See Ibid at 260. Apart from the portion relating to taxation the judgement of Shah, J., it is submitted, should be taken as correct regarding the meaning of "trade, commerce and intercourse. "Acquisition of property by itself cannot violate Art.301" observed Ray, J., in R.C.Cooper v. Union of India, A.I.R.(1970) S.C.564,634.

81. Ibid at 240.

kinds of means of transport, for example, providing new roads or improving old ones and taxation in such cases was held to be not an impediment.[82] According to his lordship "taxation simpliciter" ie. taxation for the purpose of revenue was outside the scope of Art.301 and any barrier in the guise of a tax could be dealt with under Art.304(a)[83]

The majority view was that any taxation by states which directly and immediately affected trade or commerce was hit by Art.301 and hence to be valid had to comply with the conditions laid down under Art.304(b) That is tosay, any such legislation imposing a tax had to receive the prior assent of the President of India before the bill was introduced in the state legislature and such a tax ought tobe a reasonable restriction in the interests of general public. The Assam statute was struck down for want of President's assent.

The view of the majority in Atiabari case, it could be seen, would put the taxing power of states at a disadvantage as presidential sanction was required for imposing

82. Ibid at 240. It is submitted that this view has been followed later in Automobile Transports v. Rajasthan, A.I.R (1962) S.C.1406,1422 though the majority in that case purported to reject the view of Chief Justice Sinha in the Attiabari case.

83. See Ibid at 241.

such a tax.[84] As the learned Chief Justice pointed out, taxation in every case could not be an impediment. For example, a cess on cane growers for making transport facilities to reach the cane to the factory makes it feasinle for opening new means of communication or for improving old ones. According to his lordship, the public purpose is implicit in every taxation except where it imposes a high tariff wall, or prevents[85] imports into or exports out of a state. Hence the question really boils down to whether the tax in its true nature and effect is an impediment to the free flow of goods and commodities between one state and another. It was also pointed out that the Assam legislation was a simple taxing statute and also that it would not be in the interest of Assam to put any such impediments as Assam was a tea producing state which had to send the goods to Calcutta for export.[86]

The matter was subject of another decision in Automobile Transport (Rajasthan) Ltd. v. Rajasthan.[87] The appellants carried on the business of plying stage carriages

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84. See Sinha, C.J., at 240. "That will be putting too great an impediment to the power of taxation vested in the States and reduce the State's limited sovereignty under the Constitution to a mere fiction". The majority view was also fallacious because of the insistence that any such tax should follow the procedure mentioned in Art.304(b). At the same time taxation by Union Legislature was subject to no such limitation.
85. See Ibid at 241. The view was that it was not from Art.304 that state legislatures did derive the power but that article only left the power in tact with some restrictions.
86. Ibid at 243.
87. A.I.R.(1962) S.C.1406. An entirely new bench of Judges heard the appeal. S.K.Das, J., Kapur and Sarkar, JJ., along with Subba Rao, J., constituted the majority. Hidayatullah, Rajagopala Ayyangar and Mudholkar, JJ., constituted the minority.

between two stations in the State of Ajmer[88] and between two stationsin Ajmer and State of Rajasthan.[89] Regarding both these routes the appellant's vehicles had to travel through a portion of the roads in the State of Rajasthan. The appellants were asked to pay tax under the Rajasthan Motor Vehicles Taxation Act, 1951.[90] S.K.Das, J., examined the three lines of views propounded in Atiabari decision in detail. The view of Shah, J., was rejected as its adoption, it was held, would result for all practical purposes in "an end of State autonomy even within the fields alloted to them under the distribution of powers by our Constitution"[91] All laws whether dealing with taxation or not which have only an indirect effect on trade and commerce were held to be beyond the reach of Art.304(b). The majority also rejected the other view characterised as the "narrow interpretation" by Sinha, C.J., The majority view

88. Nasirabad – Deoli route.

89. Ajmer – Kishangarh route.

90. S.4 of the Act prohibited use in any public place or keeping for such use any vehicle except where the tax had been paid.

91. A.I.R.(1962) S.C.1406,1421.This view was rejected by the minority judges also.See Ibid at 1459.

in Atibari case was adopted with a clarification that regulatory measures and measures imposing compensatory taxes[92] did not fall within the purview of Art.301 and hence need not comply with the proviso to Art.304(b). The Rajasthan statute was found to be compensatory as the tax was found not at all heavy[93] and the State was found to spend more for the upkeep and maintenance of the roads than it received by way of tax.

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92. Ibid at 1424. The exclusion of regulatory measures from Art.304(b) is difficult to understand. This is because the underlying purpose of Art.304(b) is to ensure uniformity in regulatory measures throughout the country for example, traffic regulations. Perhaps the Court was under the influence of Australian case Hughes & Vale Pt. Ltd. v. New South Wales, (1955) 93 C.L.R. 127, 162-163. See also Fullagar, J. (dissenting) in McCarter v. Brodie, (1950) 80 C.L.R. 432, 496. A distinction between a regulatory measure and a prohibitive measure is unwarranted under the Indian Constitution as the Union Executive has been made the final judge to decide whether any such regulation should be allowed or not. Further it is understandable when the court makes an exception towards state taxation without Central permission but not in the case of regulation when Art.304(b) seeks to make such regulations uniform throughout India through Central approval.

93. It worked to 1 anna per a maund in the case of goods vehicles. See at P.1425, from the judgement of the High Court in Automobile Tr. Ltd. v. Rajasthan, A.I.R. (1958) Raj. 114, 117.

Subba Rao, J., who concurred with the majority[94] held that restrictions obstructed the freedom while regulations promoted it. Regulations suchas provision for lighting, speed, good condition of vehicles, timings, rules of the road and similar others really facilitate the freedom of movement rather than retard it. Regarding the application of this part to taxation statutes the learned judge observed[95] that in cases where such taxes had only an indirect effect as in where vehicles were taxed as property, the tax would be valid. Even in such cases if the burden is very heavy, it may be considered as direct burden.

The minority judgement was delivered by Hidayatullah, J., who reviewed the constitutional history of India with regard to Part XIII of the Constitution of India,[96] According to his lordship the only taxes which are outside the purview of Art.301 are general taxes which fall on all persons including those engaged in trade and commerce.[97] Regarding trade barriers it was observed that restrictions might be diverse, subtle and disguised and the nature of tax and its effect on

94. Ibid at 1430.
95. Ibid at 1433.
96. Ibid at 1446-1450.
97. Ibid at 1460 for example property tax or income tax. In an Australian case Commonwealth Freighters Pty.Ltd. v. Sneddon,(1959) 102 C.L.R.280,289 Dixon, J.,observed that the incidents of inter-state commerce which were prima facie open to taxation without hindrance were "on premises occupied by a carrier carrying on an Inter-State business; his profits may be taxed; so may his petrol".

trade and commerce were held to be the things to be considered.[98] Regarding the Australian concept of regulatory and compensatory measures the learned judge observed that the detailed provisions of Part XIII rendered such a construction unnecessary and impermissible.[99] It was also held that so far as out of state vehicles were concerned, as in the present case, their entry into the state was barred unless the tax was paid.[100] The learned judge also pointed out that the particular tax levied would not be regarded as compensatory or regulatory even in Australia.[101] The tax was held not incidental to trade but directly on it and on its movement.

98. Ibid at 1460
99. Ibid at 1461.
100. Ibid at 1463. The tax was discriminatory also as a vehicle travelling hundred miles and another travelling only one mile had to pay an identical sum as tax. That is to say, that the tax was not " a fair recompense for the wear and tear of roads" But this was only in relation to vehicles which travel in inter-state routes.
101. See Ibid at 1463. Dixon, C.J., in <u>Hughes & Vale Pty. Ltd.</u> v. <u>New South Wales,</u> (1955) 93 C.L.R. 127, 182 "It is true that the proceeds of the tax go into road funds but on the other hand not only is there no definite relation between the tax and the amount of use made of highways by the vehicle, but there is nothing on the face of the Act to show a relation between the amounts of the tax and any attempt at fixing a due proportion of the recurrent expenditure of the State upon the facility provided and used".

From the above discussion it is clear that the majority accepted the general principle that the compensatory or regulatory provisions, whether by way of a tax or not, would not attract the proviso to Art.304(b). Hence firstly, the states are free to impose such restrictions without the concurrence of the federal executive and secondly such measures may also pass the test of "reasonableness in the interest of public" easily. The latter part of the statement only means that a regulatory or compensatory provision usually would be viewed by courts as a reasonable restriction on the freedom of commerce and this initial presumption may be rebutted by persons who allege the contrary.

In other federations like U.S.A., and Australia also it is an accepted principle that the inter-state business must pay its way.[102] The term tax barrier applies, in U.S.A., only to those taxes which tend to place inter-state business at a disadvantage in competing with local business.[103] Apart from these

102. Stone.J., Western LiveStock v. Bureau of Revenue, (1938) 303. U.S.250,254.

103. See William B.Lockhart, "State Trade Barriers To Inter-State Trade"(1940) 53 Har.L.Rev.1253. The motor vehicle should pay for using the highway(Aero Mayflower Transit Co. v. Board of R.R.Commrs., (1947) 322 U.S.495 and Bode v. Barrett, (1953) 344 U.S.583) if the tax has a reasonable relation to the use of the highway. McCaroll v. Dixie Greyhound Lines, (1939) 309 U.S.176(a tax on vehicles carrying more than twenty gallons of gasoline was struck down) ;Inter-State Transit v. Lindsey, (1931) 283 U.S. 183,186 (a tax related to the earning capacity of the vehicle was struck down).

general principles the law in U.S.A., on this point is far from clear and it has been observed "seizing both horns of the dilemma, one horn playing the melody that inter-state commerce must be free of taxation and the other that even inter-state commerce must pay its way, the Court has scarcely resolved the dissonance."[104] In Australia the matter was subject of a decision of the Privy Council in Freight Lines and Construction Holding Ltd. v. New South Wales,[105] and it was held that if a state fixed a charge for the convenience or service provided by it or its agency and imposed it upon those who chose to avail themselves of it, the freedom of commerce under Sec.92 might well be considered unimpaired.[106] In Australia it has been held that the cost incurred in enforcement of a law against pillaging of cargo could not be raised by a tax upon goods discharged from inter-state ships or that a tax could not be imposed upon transport of goods or passengers by road in order to meet the cost of enforcing the traffic laws. The exact frontiers of such taxation are bound to remain unclear even in the face of the attempt by eminent judges to fix them precisely.

104. Paul A.Freund,"Umpiring The Federal System"(1954) 54 Col.L.Rev.561,-569-570.
105. (1961) 116 C.L.R.1.
106. Ibid at 5. The earlier decisions of the Australin High Court were approved.
107. Dixon, C.J. in Hughes and Vale Pty.Ltd. v. New South Wales,(1955) 93 C.L.R.127, 176-177.

The majority view in the Automobile case that a compensatory tax or a regulatory measure is not within the purview of the proviso to Art.304(b) seems to have been accepted ta as the law on the point though Gajendragadkar, J., was not ready to agree on the same.[108] That a compensatory tax also can be a reasonable restriction under Art.304(b) seems to be clear from the decision in Khyberbari Tea co. v. Assam.[109] The case was concerned with the validity of Assam Taxation(on Goods Carried by Road or on Inland Water Ways)Act,1961. The Assam Act, which was struck down in Attiabari Tea Co. v.Assam,[110] was reenacted and received the assent of the President of India. The only question remained to be considered was whether the tax was a reasonable restriction under Art.304(b). The majority judgement was delivered by Gajendragadkar, J., and it was assumed that the tax was not compensatory in character.[111] The

108. See Rai Ramakrishnan v. Bihar,A.I.R.(1963) S.C.1667,1677 "Part XIII contains provisions which constitute a self contained code and we need not really travel outside the said provisions in determining the validity of the tax imposed by the Act" and in Khyerbari Tea Co. v.Assam,A.I.R.(1964) S.C.925,933, that the matter ought to be heard by a larger bench.

109 A.I.R.(1964) S.C.925-940. Gajendragadkar, J.,observed "It may perhaps be that since ton-mileage method has not been adopted in imposing the tax, the State may not be able to claim that the tax is not compensatory in character".

110. A.I.R.(1961) S.C.232.

111. See A.I.R.(1964) S.C.925-933. The Assam High Court had also held to the same effect.The majority view seems to imply that only where a tax adopts ton-mileage basis it could be claimed as compensatory in character. The majority observed "Usually, compensatory character may be claimed for a tax of this kind, provided the extent of the service rendered by the State by raising the tax is shown and it is also proved that the recovery of tax has some relation to the rendering of the said service" Ibid at 940.

Court held that the tax was levied not merely to raise general revenue for the State(which itself was a public purpose)[112] but the tax was raised and utilised for keeping the waterways and the roads in good condition in the State and that would render the tax a reasonable restriction on inter-state trade. The State had filed an affidavit in which it was stated that tea and jute were ths main products of ths state and in order to have an easy and regular flow of trade the State had to maintain good roads. The trade through water was cheaper and the State also had to incur large sums for mainteining the waterways. The afidavit also showed theat every year the expenditure incurred was much more than the revenue received from carriage tax.[113] It was held that this fect was sufficient to uphold the tax as a reasonable restriction.

It is true that the majority held that the tax here was not compensatory in character.But applying the test of the majority in Automobile case, namely, whether a state needs the collection of the tax to maintain or construct new facilities for the flow of trade and commerce the tax could have been upheld as compensatory in character.[114] Recently in Assam v. Lobanya Probha Devi,[115] the Assam Motor Vehicles Tax Amendment

112. Ibid at 940. The revenue raised by texation serves public purpose and renders the tax a reasonable restriction.The Court held that, that consideration though not irrelevant, its significance and importance could not be overrated.
113. See Ibid at 940.
114. The majority in Khyerbari decision, itis submitted, really applied the minority test of compensatory tax laid down in Automobile case.
115. A.I.R.(1967) S.C.1575.

Acts of 1963 and 1966 which added new schedules to the Act prescribing new rates of tax for vehicles were challenged.[116] The Court found that during the year 1962-63 the State had expended Rs.672 lakhs as against an income of Rs.76 lakhs from tax and that during 1965-66 it had expended Rs.1500 lakhs against Rs.138 lakhs which was the tax receipt. The Court held that the State was charging only 10 to 11% of the expenditure incurred by it for the maintenance of the roads. The Acts were held to be "only regulatory measures imposing compensatory taxes for facilitating trade, commerce and intercourse".[117]

In Nazeeria Motor Service v. Andhra Pradesh,[118] the State did not attempt to justify the tax as a compensatory or regulatory measure and hence the court examined the reasonableness of the levy under Art.304(b). The tax was sustained on the ground that the operators were permitted to increase the fares and freight charges and the burden of tax would not fall upon the operators but only on the passengers and goods.[119] It is submitted, that the reasoning is subject to one criticism. Such a consideration may be valid in determining the reasonableness of a restriction under Art.19(1) (g) when an operator comes forward saying that his right to do business in operating stage carriage is affected. Under Art.304(b) the test is whether movement of goods is immediately and directly affected. If the

116. Ibid at 1577.
117. Ibid at 1578.
118. A.I.R.(1970) S.C.1864. The tax imposed by Andhra Pradesh Motor Vehicles (T.P.G.) Amendment and Validation Act,1961 was challenged: See Udaya Motor Tr. v. Karnataka,(1975) Tax L.R.1604 (Karnataka).
119. Ibid at 1867 (Grover, J.).

operators are allowed to pass on the burden of tax to the persons who send goods, the goods will have to bear the burden. So such consideration should naturally militate against the concept of reasonableness under Art.304(b).The Court, it is submitted, ought to have given some other valid reason for upholding the statute.[120] But in Shaik Madar Saheb v. Andhra Pradesh,[121] the same statute was held to be of compensatory nature taking into account the cost of expenditure incurred by the State and the revenue received from taxation. It is submitted, that the distinction, attempted by the court in characterising only motor Vehicles taxation Acts as compensatory and not motor Vehicles taxation on passengers and goods Acts, is artificial and should be avoided.[122]

A tax may be imposed for regulatory purposes, for revenue purposes, as a compensatory measure to defray the whole or part of the expenses incurred or a protective tariff on inter-state goods. The last one, if on goods is prohibited under

120.The Court assumed that the tests of reasonableness were same for both Art.19(1) (g) and Art.304(b). In Khyerbari Tea Co. case the owners of tea had come forward with the challenge and it is submitted that only in such a case the tests can be same.

121.A.I.R.(1972) S.C.1804,1809.

122.This seems to be the reason innot labelling the tax in Khyerbari case a compensatory tax. See Suchet Singh v. Jammu & Kashmir,A.I.R.(1970) J.& K.112 where J.K. Passengers Taxation Act was held to be compensatory in nature.

Art.304(a). The regulatory taxes and compensatory taxes are outside the purview of the freedom guaranteed under Part XIII of the Constitution.[123] Then the only remaining category of tax is one imposed for revenue purpose, that is to say, taxation simpliciter in the language of Sinha, C.J., in Atiabari Case.

In Andhra Sugars Ltd. v. Andhra Pradesh,[124] the A.P.Sugar-Cane (Regulation of Supply and Purchase) Act, 1961 imposed a purchase tax and this was challenged as violative of Art.301 of the Constitution.[125] Rejecting the contention, the Court held that normally a tax on sale of goods did not directly impede the free movement or transport of goods.[126] The view was reiterated Madras v. Nataraja Mudaliar,[127] where the challenge against the Central Sales Tax Act was that different rates of tax prevailed

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123. See also Phoolchand v. Madhya Pradesh, A.I.R.(1966) M.P.131 134 for the view that Presidential assent is unnecessary for amendment of a statute imposing a compensatory tax.
124. A.I.R.(1968) S.C.599.
125. Ibid at 608. The Court held that the above tax was not discriminatory.
126. Venkataraman v. Madras, A.I.R.(1970) S.C.508,512; Agarwal & Sons v. Asst.Commr., A.I.R.(1971) All.1.(F.B.) ;See Walker Anjaria v. Rajasthan, A.I.R.(1969) Raj.162,166; D.R. and B.Oil Mills v. Andhra Pradesh, A.I.R.(1964) A.P.266, Vallabhadas v. S.T.O.Alleppey, A.I.R.(1963) Ker.202,214 for the view that sales tax legislations unless discriminatory in character would not attract Part XIII of the Constitution. See Sushil Chandra v. Uttar Pradesh, A.I.R.(1969) All. 317.326 a tax on profession is not hit by Art.301.
127. A.I.R.(1969) S.C.147,155. Shah, Mitter and Vaidalingam, JJ., for the majority Bachawat and Hegde, JJ., concurred. Followed in Tamilnadu, v. Sitalakshmi Mills, A.I.R.(1974) S.C.1505,1509.

in various exporting states and that resulted in discrimination and obstruction to the free flow of interstate trade in similar goods. Repelling the contention, the Court held that the flow of trade did not necessarily depend upon rates of sales-tax but did depend on a variety of circumstances such as source of supply, place of consumption, existence of trade channels etc.

It is clear from the above discussion that a tax imposed for revenue purpose also is beyond the challenge under Art.301 and 304(b). If so the only tax which seems to have been hit by Part XIII is a discriminatory tax, or better still a tax in the nature of a barrier on free trade or commerce, which is expressly prohibited under Art.304(a). If that is the conclusion, that is exactly what his lordship the Chief Justice Sinha, laid down in Atiabari Tea Co. v. Assam[128]. But at the same time it is also certain that a state should not be permitted to burden interstate trade unduly by taxation. For example, if the goods are merely carried through a state to its destinction in another state, the former state should not be free to levy any tax even if permitted to do so. If goods sent from Kerala to Punjab would be subject to tax

128. A.I.R. (1961) S.C. 232.

by all intervening states the freedom envisaged would be an empty shadow.[129] That is to say, there must be some provision to regulate such taxation. The matter requires special treatment and the fact is now agreed upon by states entering into reciprocal agreements among them for exemption of tax if such vehicles had paid tax in their state of origin. But whenever such taxes affect inter-state trade they should contain[130] special provisions alleviating the burden on inter-state commerce. For example, in the leading case of Sainik Motors v. Rajasthan[131], the Rajasthan Passengers and Goods Taxation, Act, 1959 was challenged as violative of the freedom of inter-state commerce guaranteed under Part XIII of the Constitution. The petitioners held stage carriage permits and used to ply a number of vehicles inside the State. As such no inter-state commerce was involved in the case and the Court held[132] that the freedom was not affected. The tax was held to be on goods and passengers carried within the State. The Act itself provided[133]

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129. The Atiabari case gives a good example. The tea sent from one point in the State of West Bengal to another point in that State had to travel about one and half mile of Assam territory and was liable to pay tax at the full rates.
130. This line of approach is not unmindful of the fact that part XIII controls both inter-state and intra-state commerce.
131. A.I.R.(1961) S .C.1480.
132. Ibid at 1485.
133. By S.3(3).

that in case of vehicles coming from other states the tax would be proportionate to the route travelled within the State.[134] This it could be seen is a reasonable provision making the inter state trade also contributing its due share of the cost of the local government whose protection it enjoys or services and facilities it makes use of. The proviso to S.3(3) provided that where the two termini of the route were within the State, even if a portion of the route lay in another state, tax was leviable at full rate.The Court assumed that such a route would be an inter-state route.[135] As pointed out earlier,petition-ers were doing intra-state business[136] and neither it was alleged that any inter-state route existed nor that substantial part of such a route lay in another state.

The only objection that can be levelled against the dissenting judgement of Sinha, C.J.,in Atiabari case is that it takes a very narrow view of the matter. Cases might arise where a tax simpliciter[137] might indirectly affect inter-state commerce detrimentally. For

134. See a U.S.Supreme Court decision.Ott. v.Mississippi Valley Barge Line Co.,(1949) 336 U.S.169 where it was held that a state might lawfully tax a carrier engaged in inter-state business if the tax was based on the ratio between total number of miles travelled within a state and the total number of miles of the entire line.

135. See Central Greyhound Lines v.Mealey,(1947) 334 U.S.653 where the Supreme Court held that a transportation between two points in one state over a route,the subst-antial part of which lay in another State was inter-State commerce.

136. Sainik Motors v.Rajasthan,A.I.R.(1961) 1480,1486.

137. In the sense that its incidence is not directly on commerce.

example, the accepted view[138] is that property tax is not a restriction contemplated by Part XIII of the Constitution. But if a state imposes heavy tax on vehicles coming from outside the state without any principles as to apportionment[139] it would be a burden on inter-state commerce. Whether such a case would amount to a tax barrier according to the view of the learned Chief Justice is also doubtful. The majority in Automobile case had put the test widely and in more general terms so as to bring in cases of discriminative burdens.

It is submitted that there is another simple line of interpretation which would have avoided all these unnecessary confusion. It is as follows: Every tax legislation challenged before courts as violating the freedom of commerce should be examined under Art.301 to see whether it really infringes the freedom of inter-state commerce. As pointed out earlier Art.304 (a) should be considered as an independent provision prohibiting discriminatory taxation on goods coming from outside the state.The Supreme Court was over enthusiastic to find

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~~138. In the sense that its incidence is not directly on commerce.~~

138. Bhuvaneswariah v. Mysore ,A.I.R.(1965) Mys.170,185.

139. In Bombay v.R.M.D.C.,A.I.R.(1957) S.C.699,721, the State of Bombay taxed the aggregate of entry fee received inside the State by the respondent, who conducted prize competition in cross-words in the State of Mysore.Such a tax, it is submitted would have passed any test of apportionment. But the court avoided the issue by holding that gambling was not commerce protected by Art.301.

some protection for taxation, which does not fall under Art.304 (a) but really interefexes with the freedom of commerce, when it held that tax laws had to satisfy the provisions of Art.304 (b). It is submitted that Art.304(b) applies only to regulations other than by way of taxation. If the Courts begin to examine taxation laws under Art.301 and not under Art.304(b) the present unsatisfactory state of the law under Part XIII can be remedied. If the above line of interpretation is followed the inconvenience of the states in getting presidential sanction to their taxation laws and that of the courts to examine whether a tax law is a reasonable restriction on the freedom of inter-state commerce can be avoided. The result will be either a tax law offends the freedom under Art.301 or it does not and if it offends it is struck down and presidential sanction will not be a condition precedent for the validity of a ~~tax~~ state tax.

An important question which arises for consideration is whether a tax should be strictly proportionate to the actual use of the vehicle in order to be termed compensatory. That one vehicle travelling a few miles and another using the highway for travelling great distance paying the same amount of tax would appear a little curious. But it can be also said the other way of making the tax relate to the actual use of the vehicle would result in much administrative inconvenience.[140]

140. In U.S.A, the tax need not be related to the actual use. Dixie Ohio Express Co. v. State Revenue Commission (1938) 306 U.S. 72,78. In Australia the rule is that the tax ought to be related to the weight and the distance travelled Armstrong v. Victoira, (1957) 99 C.L.R.28. In Australia a separate fund also should be created.

In Khyerbari Tea Co. v. Assam,[141] Gajendragadkar, J., observed that there was no general rule that a tax at a flat rate would always be unreasonable. According to the learned judge, the law of taxation was in the ultimate analysis the result of balancing of several complex considerations and it would be unreasonable to insist that a flat rate must always be treated as unreasonable.[142] Sarkar, J., who concurred, pointed out that if the rate varied with the distance, then it was conceivable in many cases, the burden would be much heavier. This view, it is submitted, is correct as it is doubtful whether postage charges based on the distance to which the letters were sent could be termed reasonable.

Mere data regarding amounts collected by way of tax being below the actual expenses of the state for maintaining roads, should not be sufficient or conclusive regarding the compensatory nature of the tax. For example, the judiciary would be in an embarassing position to hold whether such expenses can

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141. A.I.R.(1964) S.C.925,940. The tea growers of West Bengal who had to carry the goods through Assam waterways for a distance of one and half mile had to pay the same amount of tax like others.
142. Ibid at 947.

legitimately include capital expenditure on new high ways or bridges or only recurring expenditure with regard to maintenance and up-keep alone.[143] Again what would be the view of the judiciary if the collection exceeded the actual expenditure[144] and if so how far it should exceed in order to render the tax non compensatory? Yet another question to be answered in this area is even if the tax receipts are less than the actual expenditure for the maintenance of roads, can the state impose a higher and discriminatory tax on one class of carriers alone and attempt to support the tax as compensatory as the general expenditure on roads is more than the actual receipts from such taxation? The problem arose before the Supreme Court of India in G.K.Krishnan v.Tamil Nadu[145]. Here the rate of tax for contract carriages was increased from Rs.30/- to Rs.100/- per seat per quarter. This was done as announced by the State Government " to avoid unhealthy competition between omnibuses

143. The view in Australia is "It does not seem logical to include the capital cost of new highways or other capital expenditure in the costs taken as the basis of computation". Dixon ,C.J., Huges & Vale Pty.Ltd. v. New South Wales(No.2) (1955) 93 C.L.R.127,176. In India the question was left open by the Supreme Court of India in G.K. Krishnan v. Tamil Nadu,A.I.R.(1975) S.C.583,589.

144. In Australia the view is that did not matter even if the total amount of collections in respect of particular high way exceeded the costs of its upkeep. Dixon,C.J., in All Wrights Tr.Ltd. v.Ashley,(1962) 107 C.L.R.662,668.

145. A.I.R.(1975) S.C.583.

and regular stage carriage buses and to put down the misuse of omnibuses".[146] The Court upheld[147] the tax as a compensatory measure as it found that the State expended Rs.19.51 crores as against the receipts of Rs.16.38 crores. It is submitted, that where the avowed object[148] of atax is to eliminate a particular type of commerce from its high ways, it does not seem proper that the State should attempt to justify it as a compensatory measure.The concept of compensatory taxation is that it would not interfere with the freedom of commerce but only facilitates it as "those who pay them are not unfree, they merely pay the price of freedom".[149] Here the Court could not have held that the tax facilitates the appellant's business. It is submitted, that the finding entered by the Court that the tax is not confiscatory in nature[150] is entirely different from a finding that the tax facilitates trade and hence compensatory in nature. The decision clearly brings about the helpessness of the judiciary to enter into the ~~highway~~ highly technical realms of public finance.[151] The decision was followed in Karnataka

146. Ibid at 585.
147. Ibid at 590.
148. His Lordship Justice Mathew held that the question of motive was immaterial. Ibid at 586. It is true that when a statute is challenged as a colourable legislation the question of motive is immaterial. But such a view cannot be taken when the statute is examined under Art.304(b).
149. Dixon,C.J., in Hughes & Vale Pty. Ltd. v. New South Wales, (1955) 93 C.L.R.127,172.
150. A.I.R.(1975) S.C.583,590.
151. One is apt to wonder why the courts should take upon themselves the responsibility to review the taxation of states from the hands of Union Executive under Art.304(b).

v. D.P.Sharma.[152] These decisions highlight the error of too much reliance on figures given by the states of actual receipts from the tax and actual expenditure for maintenance of highways. It is submitted that it can be only one of the considerations to uphold the levy as compensatory in nature and in no case the sole ~~xxxxxx~~ criterion and the courts, since they have taken upon themselves the difficult task of examining state taxes to protect them from the operation of Art.304(b),[153] should in each case examine the additional factor whether the impugned tax really facilitates the commerce in question.

Provisions Against The Evasion of Tax.

A statute imposing a tax which falls outside the purview of Art.301 may contain provisions which hinder trade and commerce. For example, the various sales tax legislations of this country contain provisions to check the evasion of a tax in the nature of check posts etc.[154] It is submitted, that in

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152. A.I.R.(1975) S.C.594. For a criticism of the wide terms in which the test of compensatory taxes are defined in India see D.K.Singh, "Trade, Commerce and Inter-Course in India: A Reappraisal of Some Constitutional Problems" (1972) 14 J.I.L.T. 39 at 63-71.

153. If a tax is held to be compensatory in nature, then normally the question of its reasonableness is out of question. But in practice the reasonableness could be tested also under Art.19 (i)(g) and hence not much harm is done. But if a court upholds the levy as compensatory under Art.304(b), it would be all the more impossible to hold it an unreasonable restriction under Art.19(1)(g).

154. See Rama Transport Co. v. Uttar Pradesh, A.I.R.(1957) All. 446 where a provision in U.P.Sales Tax Act which provided for a declaration of the owner of goods in the prescribed from a was upheld under Art.301.

such cases absolute uniformity is necessary as difference in law in different states would result in much hardship hindering the free flow of goods. In Hans Raj Bagrecha v. Bihar,[155] Section 42 of Bihar Sales Tax Act,1951 provided that notified goods in excess of certain specified quantity could be transmitted from any railway station only by obtaining a despatch permit from the prescribed authority. The Court held that although the Bihar Legislature had competence to make provisions regarding evasion of tax on intra-state sale or purchase, the Legislature was incompetent to legislate on transactions which were carried on in the course of inter-state trade or commerce or in the course of export. The appellant had purchased jute from both within and without the State. It was held that such provisions could be valid only as regards purchases made intra-state.

In Yogesh Trading Co. v. The Intelligence Officer,[156] S.29 of Kerala General Sales Tax,Act,1963 which provided for check posts and for inspection of goods and documents relating to ownership was challenged by a dealer in Mahe, a part of the Union Territory of Pondicherry.The said Mahe is land locked on all sides by frontiers of Kerala State and the petitioner could not have avoided the check posts in Kerala State in sending

155.(1971) 1S.C.C.59.
156.A.I.R.(1970) Ker.218 (F.B.).

his goods out of Mahe. This special feature of the case cannot be overlooked as the check post system was really a hindrance on the inter-state transport of goods so far as a dealer in Mahe was concerned. The Court struck down the provision as hindering the movement of goods and for absence of presidential sanction under Art.304(b). It seems that the Court ought to have confined the ruling to the inter-state commerce aspect in view of the decision in Hans Raj Bagrecha v. Bihar.[157] The court had followed the decision in Mysore v. H.Sanjeeviah,[158] where a prohibition of transport of timber during night time in order to check illegal transit of timber was struck down as offending Art.301. Gopalan Nambiar, J., discussing the effect of the section on the movement of goods pointed out[159] that there was not even a guarantee that a clearance at one check post would afford a sufficient passport at another, at least in respect of matters checked and verified. It is submitted, that the insistence of Presidental assent should lead the way for a simplified and much less cumbersome, uniform procedure throughout India.

157. (1971) 1 S.C.C.59.
158. A.I.R.(1967) S.C.1189.
159. A.I.R.(1970) Ker.218,224.

CHAPTER XV

SALES TAX AND FREEDOM OF COMMERCE

1. Sales Tax on Inter-State Trade.

The power to impose tax on sale or purchase of goods is a matter, generally, within the exclusive jurisdiction of the states in India, that is to say, when such sale or purchase is essentially of an intra-state character. But once it assumes an inter-state character more than one state come to the picture, for example, the state where the goods existed, the state where the goods were ultimately delivered as a consequence of the sale and the state where the property in the goods passed. Though theoretically speaking it could be assumed that as the power to tax was only on sales and not on any of the ingredients constituting a sale and that in law a sale could not have more than one situs, only one of such states could be permitted to reach such a transaction.[1] But prior to the Constitution of India there existed no restriction on different states reaching such transactions for the purpose of

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1. See the dissenting opinion of Vivian Bose, J., in Tata Iron & Steel Co. v. Bihar, A.I.R.(1958) S.C.452,462. The learned judge advocated the adoption of the doctrine of proper law in private international law.

imposing sales tax on the theory of territorial nexus.[2] Apart from S.297 of the Government of India Act,1935, there existed no guarantee as to freedom of inter-state trade and commerce.

The Constitution of India by Art.286 attempted to regulate the power of states to levy sales tax with regard to certain circumstances.The said article was the subject matter of a constitutional amendment[3] in 1956. Hence a detailed discussion of the law as it existed prior to the constitutional amendment is not attempted here.The discussion of power to tax inter-state sales is arranged period wise here, for example,

a) The state of affairs as existed under the law laid down by the Supreme Court in Bombay v. United Motors Ltd.[4], and upto the decision of Bengal Immunity Co. v. Bihar[5] decided on September 6,1955 regarding the interpretation of Art.286(1) (a) and (2) before the amendment to the Constitution,

b) Then secondly, upto the enactment of the Sales Tax Laws Validation Act,1956,

c) Thirdly,from Sept.7,1955 to Sept.11,1956 ie.,the date of which the Constitution(Sixth Amendment) Act,1956 came into operation,

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2.See Tata Iron & Steel Co. v. Bihar,A.I.R.(1958) S.C.452;Poppat Lal Shah v. Madras,A.I.R.(1953) S.C.274,276. See also a recent decision in Venkatasatyanarayana & Bros. v. Andhra Pradesh, A.I.R.(1970) S.C306.
3.Constitution(Sixth Amendment) Act,1956,S.4.
4.A.I.R.(1953) S.C.252.
5.A.I.R.(1955) S.C.661.

d) Fourthly, for a period from Sept.11,1956 to January 5,1975, i.e. the date on which the Central Sales Tax Act,1956 was brought into force,

and (e) finally, the legal position available under the Central Sales Tax Act,1956.

The other restrictions put by Art.286 and Central Sales Tax Act,1956 on the power of states to impose tax on sale or purchase in the course ofexport or import and on sale or purchase of goods declared to be essential to the life of the community are dealt with separately in this chapter.

(a) <u>Position under Unamended Art.286</u>.

Article 286 before amendment in 1956 read as follows:

"(1) Not 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 purpose 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 thirty-first day of March 1951.

(3) No law made by the Legislature of 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".

Thus it could be seen that Art.286 puts four restrictions on the power of states to levy tax.i.e.(1) on outside sales(2) on sales in the course of export or import, (3) inter-state sales and purchases and (4) on goods declared by Parliament to be essential for the life of the community. At present we have concerned only with Art.286(1)(a) and sub clause(2) of the said article.

The true meaning and content of these sub clauses were subject to conflicting judicial opinions resulting in a constitutional amendment.[6] In Bombay v.[7] United Motors. Patanjali Sastri, C.J., for the majority observed that the explanation to Art.286(1)(a) converted in effect all inter-state sales and purchases to intra-state sales and purchases occuring in the state where goods were delivered for the purpose of consumption. By adopting this view, though the majority found out a solution for multiple taxation of inter-state sales, Art.286(2) which provided for Union legislation in that area became otiose and nugatory. It is true that the Parliament had also not acted under Art.286(2). [8] Bagawati, J., in a concurring judgement held that under the explanation to Art.286(1) (a) the state in which goods were delivered for consumption could tax inter-state sales and purchases, but if Parliament lifted the ban under Art.286(2) the state in which property in goods passed under the general law relating to transfer of goods, also could tax such sales and purchases.

6.A.I.R.(1953) S.C.252,257.

7.Patanjali Sastri, C.J., Mukherjea and Ghulam Hassan, JJ. Bose, J., took the view that the explanation to Art.286(1) only located the sale and such sale was taxable only if Parliament lifted the ban under Art.286(2). See Ibid at 265. A similar view was expressed by S.R.Das.J., In State of Travancore Cochin v.S.V.C. N.Factory,A.I.R.(1953) S.C.333,343.

8.A.I.R.(1953) S.C.252.

It is submitted, that this latter view was clearly untenable as Art.286(2) conferred power on Parliament to decide principles as to how inter-state sales had to be taxed and there was nothing in Art.286(2) which could be said in support of the view that states in which property in goods passed could tax inter state sales as soon as Parliament acted uneer Art.286(2). Thus State of Bombay from which the company had sent goods to other states was prohibited from taxing those transactions.

The decisions in United Motors case in fact solved the problem of multiple taxation of inter-state sales and purchases. But since only the state where the delivery of goods was made had jurisdiction to tax such transactions, dealers who effected inter-state sales throughout the country had to register themselves under different sales tax legislations prevailing in various states and to file returns respectively in all such places.This evoked much criticism among the business community also. Further, the inherent infirmity in the reasoning adopted by the Court in the United Motors decision with respect to the interpretation of Art.286 may be pointed out.That is to say, if we adopt that reasoning, Art.286(2) becomes completely innocuous. For example, since Constitution itself provided that all inter-state sales had the character of intra-state sales occuring in the delivery state, what was the ban contemplated under Art.286(2) to be lifted by the Parliament for the purpose of taxing inter-state sale is difficult to understand.

All these considerations led the Supreme Court in 1955 to hold that the United Motors case was wrongly decided. In Bengal Immunity Co. v. Bihar,[9] the Court held that the explanation to Art.286(1)(a) could not control the provision under Art.286(2) and that until Parliament by law provided for taxation of inter-state sales, no state could tax such transactions. It is submitted that though the view expressed by the Supreme Court in Bengal Immunity Co. case is correct, the reversal of the earlier view had much effect[10] on the financial position of states as all states had started to tax inter-state sales in accordance with the view expressed in United Motors case. It is also worth mentioning that though hitherto the Supreme Court had overruled some of its earlier decisions, none had such an impact on the economic affairs of the country. Thus on September 6, 1955 the legal position was that no state was legally entitled to tax sale or purchase of goods when such transaction took place in the course of inter-state trade or commerce as Parliament had not taken action under Article 286(2).

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9. A.I.R.(1955) S.C.661. Venkatarama Aiyar and Jagannath Das, JJ., dissented. Bhagwati, J., who was a party to the United Motors case concurred with the majority.

10. For criticism see Seervai, H.M., Constitutional Law of India, (1967) P.931.

(b) Position up to the enactment of Sales Tax Laws Validation Act,1956.

The criticism evoked by the Bengal Immunity Co.x case and the pressure from the states brought out an Ordinance by the President of India, the Sales Tax Laws validation Ordinance, 1956[11] the provisions of which were later embodied in the Sales Tax Laws Validation Act,1956. The Act provided that "notwithstanding any judgement, decree or order of any court, no law of a State imposing or authorising the imposition of a tax on the sale or purchase of any goods where such sale or purchase took place in the course of inter-state trade or commerce during the period between the Ist day of April, 1951 and the 6th day of September,1955 shall be deemed to be invalid or ever to have been invalid merely by reason of the fact that such sale or purchase took place in the course of inter-State trade or commerce and all such taxes levied or collected or purported to have been levied or collected during the aforesaid period shall be deemed always to have been validly levied or collected in accordance with law".The effect of the Sales Tax Laws Validation Act,1956 was that the Parliament retrespectively lifted the ban under Art.286(2) and validated

11.On January 30,1956.

the taxation of sale or purchase taking place in the course of inter-state trade or commerce up to September 6,1955. That is to say, that the state in which the delivery of goods was made as a result of inter-state ~~w~~ sale or purchase could tax such transactions.Thus in limiting the validation only and upto the date of the judgement of Bengal Immunity Co. case the Parliament of India seized the opportunity to reconsider the matter in the light of the judgement and the experience ~~guaranteed~~ garnered in these years.

The Validation Act was challenged in Sunderaramier & Co. v. Andhra Pradesh,[12] before the Supreme Court and the Court held that the Act was in fact not a validation Act as the title of the Act suggested but a law lifting the ban under Art. 286(2),[13] which power, it was held, could be exercised prospectively as well as retrospectively. But the main ground of challenge by the petitioners was that there was no power under the Madras General Sales Tax Act to impose a tax on an 'explanation sale" and hence the provisions of Sales Tax Validation Act would serve no purpose.The position under the Madras General Sales Tax Act as it stood before the commencement of the Constitution was that the State had power to tax only those inter-state sales

12. A.I.R.(1958) S.C.468. Petitioners approached the Court under Art.32.

13. Ibid at 487; see also Pashabhai Patel v.S.I.H.Razvi,A.I.R. (1958) S.C.903.

in which property in goods passed inside the State.[14] On behalf of the State Government it was contended that the necessary amendment was incorporated in the statute through the Adaptation of Laws Order,1950, passed by the President of India under Article 372(2)[15] of the Constitution.The Adaptation of Laws Order, 1950 had only incorporated the provisions of Art. 286 as it stood at the commencement of the Constitution into the State sales tax legislation by S.22. The petitioners relied on an observation in the decision of Bengal Immunity Co. v. Bihar,[16] that the ~~expiatmien~~ explanation to Art.286(2)(a) did not confer any legislative power on state Legislatures to contend that the mere incorporation of the provisions of Art.286 would not confer authority to tax "explanation sales". Rejecting this contention,the Court held that even where the Adaptation of Laws Order went beyond its proper scope the same

14 See Poppat Lal Shah v.Madras, A.I.R.(1953) S.C.274,277

15. Sub Clause(2) of Art.372 reads. "For the purpose of bringing the provisions of any law in force in the territory of India into accord with the provisions of this Constitution the President may by order make such adaptations and modifications of such law, whether by way of repeal or amendment, as may be necessary or expedient, and provide that the law, shall as from such date as may be specified in the order, have effect subject to the adaptation and modifications so made, and any such adaptation or modification shall not be questioned in any court of law".

16. A.I.R.(1955) S.C.661,677-678.

was made non justiciable by the Constitution. It was held[17] that if in the exercise of the power of adaptation the explanation to Art.286(1)(a) could prohibit the taxation of outside sales" we fail to see why it should not operate to give effect to the other aspect of the concept which is so integrally connected with it viz., taxing of sales in which goods are delivered for consumption in the State of Madras".

It is submitted, that the reasoning of the Supreme Court that S.22 of Madras General Sales Tax Act conferred power to tax 'explanation sale' is not convincing. By incorporating the provisions of Art.286 the Adaptation of Laws Order only provided that state legislatures might exercise the power to tax 'explanation sales". The fact remained that such a power was not exercised because of a misunderstanding as to the effect of the incorporation of S.22. To lend lip service to a view, that an adaptation order under Art.372 could legislate on any topic on behalf of a legislature, by the Supreme Court has little to commend itself.

The position of law as existed under the explanation to Art.286(1) (a) may be briefly mentioned here.Though Art.264 before the VII Amendment to the Constitution of India stated that the term state in Part XII of the Constitution did not include a Part C State, it has been held[18] that Art.286 was

17.Ibid at 481 (Venkatarama Aiyar,J.).
18.See Commr.,Sales Tax Indore v. Mohd.Hussain,A.I.R.(1969)S.C 549,551.

applicable to a Part C State.[19] The courts have taken the view that in order to bring a transaction within the ambit of the explanation to Art.286(1)(a), the goods ought to have been delivered pursuant to a contract of sale out side the state and that such delivery meant only physical delivery.[20] Hence notional delivery of goods by transfer of documents[21] and delivery of goods to a common a carrier[22] have been held not to be actual delivery within the meaning of the explanation.

Another question which arose as to the interpretation of the explanation to Art.286(1) (a) was whether actual consumption of goods delivered inside a state was necessary to attract the explanation. For example, what happens if the goods were again sent out of such state into a third state for consumption. In India Copper Corpn.Ltd. v. Bihar,[23] it was held that the assessee need not prove that the goods delivered by him were actually consumed within that State for the purpose of bringing the transaction within the ambit of the

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19. See for earlier contrary view, Associated Cement Companies v. Andhra Pradesh, A.I.R.(1962) A.P.522; Indian Standard Wagon Co. v. Commrl. Tax Officer, A.I.R.(1960) Cal.25 that even delivery inside a state to an agent would not be sufficient.
20. Bajarang Jute Mills v. Andhra Pradesh, A.I.R.(1966) S.C. 376,379; Khaitan Minerals v. S.T.App.Tribunal, A.I.R.(1963) Mys.141; Burhanpur Tapti Mills v. Madhya Pradesh, A.I.R. (1962) M.P.225,232; Capco Ltd. v. S.T.Officer, A.I.R.(1960) All.62,64.
21. Govindarajalu Naidu & Co. v. Madras, A.I.R.(1953) Mad.116, 128.
22. Burhanpur Tapti Mills v.Madhya Pradesh, A.I.R.(1962) M.P. 225,232.
23. A.I.R.(1961) S.C.347,353, followed in Venkatasatyanarayana & Bros. v.Andhra Pradesh, A.I.R.(1970) S.C.306,309; see also S.T.Commr. v. Sakhigopal Coconut Grower Co.op.Society A.I.R.(1962) Ori.99,100.

explanation. In this case though goods were delivered in another state, such delivery was not for the purpose of consumption. The majority as well as the minority held that such sales were not covered by the explanation.[24] Rajagopala Ayyangar J., speaking for the majority consisting of Hidayatullah, Das Gupta, JJ., and himself held[25] that the passing of property within a state alone was intended after the Constitution to be fastened upon for the purpose of determining whether the sale was inside or outside a state. The State of Bihar in which property in goods passed was held competent to tax' non explanation' sales.[26] Shah and S.K.Das, JJ., were of the view that the sale transactions not falling within the explanation to Art.286(1)(a) could be taxed on the application of the doctrine of territorial nexus. According to this view, once it is found that the explanation would not apply to a particular sale, the doctrine of territorial nexus. According to this view, once it is found that the explanation would not apply to a particular sale, the doctrine of territorial nexus would apply and any state which can show to have some connection with the sale transaction could tax the sale.

24.A.I.R.(1961) S.C.347,351(Ayyangar J.) Shah,J., at p.355.
25.A.I.R.(1961) S.C.347,351-352.
26.Ibid at 355.

It is submitted that both these views, that of the majority as well as that of the minority, are untenable. Firstly, it was not at all pertinent to investigate whether goods were actually "consumed" within the other State as what was required for the purpose of attracting the application of the explanation was only delivery in a state for the purpose of consumption. Consumption in this sense should not mean its ordinary dictionary meaning of destruction.[27] For example, if under a single contract of sale, goods are delivered in another state, the explanation is applicable notwithstanding the intention of the buyer as to the future use of the goods. This view is fortified when we see that a strict application of the meaning of the word "consumption" would necessarily exclude even a resale of such commodity by the buyer dealer inside the delivery state. That was not a thing certainly intended by the framers of the Constitution for such a view would make the explanation almost nugatory as only in cases where the buyer is himself the consumer, the explanation would be applicable. This was the real effect of the view of the Supreme Court. It was to obviate this contingency that the Court held that the assessee need not prove such consumption within the delivery state. But the problem is slightly different-why should not he show that the delivery in the other state was not for consumption if he can escape the assesement in the delivery state.

27. See Bose, J., in Bombay v. United Motors, A.I.R. (1953) S.C. 252, 266.

Secondly, the views expressed by the majority as well as the minority are against the provisions of Art.286 as interpreted in Bengal Immunity Co. v. Bihar [28]. For, as interpreted by the Supreme Court no inter-state sale could be taxed until Parliament had lifted the ban under Art.286(2). Only when the ban is so lifted even an explanation sale became taxable by the delivery state. It is submitted that if a particular inter-state sale was not covered by the explanation, such a sale was not taxable by any state. Instead of following the straight and simple line of interpretation the Court itself has brought in unnecessary confusion in this area. For exampbe, in Bajrang Jute Mills v. Andhra Pradesh [29], a case concerned with a purely 'explanation sale' Shah,J., observed; "The sales in the present case are not sales, which have taken place in the course of inter-State trade or commerce. The only point of contest is whether they are "outside the State" of Andhra."

One is apt to wonder how many kinds of sales there are-intra-state sales, inter-state sales, 'explanation sales' inside state sales, outside state sales etc!.Perhaps the approach ought to have been to see whether a sale is of inter-state character. Only if it is of inter-state character, the further enquiry arises whether it was an expàanation sale in which case the delivery state alone gets jurisdiction to tax it. Instead, to say that the sale was not of an inter-state nature and then to add that it was an' explanation sale'

28.A.I.R.(1955) S.C.661.
29.A.I.R.(1966) S.C.376,379.

is to enter unintelligibility.

The view that the situs of non explanation sales has to be determined by applying the test of passing of title in goods has been applied in later decisions also. In A.V. Thomas & Co. v. Dy. Commr., Agri. I.T. and Sales Tax,[30] the facts were as follows. Tea was stored in godowns situated in former Travancore -Cochin State. Samples of such tea were taken to a nearby town Fort Cochin, (which was at that time in the territory of the Madras State) and sold in public auction there. The purchase price was paid at Fort Cochin but the purchasers themselves took delivery of tea from the godowns in T.C. State and were in fact dispatched to other parts of India as well as to places out side India. It was held[31] that the sale was an outside sale and the fiction created by the explanation was inapplicable as there was no delivery as a direct result of sale for the purpose of consumption in any particular state.[32] It was also held that the explanation only clarified what a sale outside the state was. A fiction was created as between two states, one, where goods were delivered for consumption in the state and the other where the title in goods passed, and the former was treated as the situs of the taxable event to the exclusion of the latter. That is to say, that the explanation only resolves the questions of situs of the sale, and does not

30. A.I.R. (1964) S.C. 569; See also Tobacco Mfgs. v. S.T. Commr., A.I.R. (1961) S.C. 402, 408.
31. A.I.R. (1964) S.C. 569, 572. (Kapur, J.)
32. Ibid at 571.

operate in the sense that the rival states claiming to tax the same taxable event in the present case are not the states of delivery for consumption and the state where the title in the goods passed. Since title to goods passed in the State of Madras, as auction was conducted there, the State of Kerala was held to have no jurisdiction to tax. The same view was followed in Malayalam Plantations v. Deputy Commr.Ag.I.T. and Sales Tax,[33] where the facts were similar to that in A.V.Thomas & Co. case. Shah.J., in a separate opinion observed that[34] " if the question raised were resintegra, I would hold that the price obtained at auction sales of tea held at Fort Cochin when the goods were lying in Warehouses in the Travancore Cochin State was liable to be taxed under the General Sales Tax Act" of T.C.State. This was on the application of the doctrine of territorial nexus.

It is submitted, that these two decisions put unnecessary restrictions on the power of State of Kerala to tax these transactions. It is submitted, that the better view would have been to treat them as only intra-state sales as the purchasers had taken delivery of goods at the godowns. The sale had not occasioned movement of goods to other states and any movement could only be after the sale, as price was already fully paid. Further, there was no contract for movement of tea outside the State of Travancore-Cochin as the purchaser was free

33.AlI.R.(1965) S.C.161.
34.Ibid at 164.

to do as he liked.[35] The practical effect of the decision was to provide a loophole to evade taxation of sales as dealers can sell them by auction in a far away state as then only that state will have jurisdiction to tax those sales. In practice, it is quite possible that such state where the auction sale was conducted may be ignorant of the whole transaction. Any way the matter has only historical importance now.

In Andhra Sugars v. Andhra Pradesh[36], it was held that the explanation to Art.286(1)(a) did not confer a power to levy a use tax. The explanation has been made use of to prohibit taxation of inter-state sales except by the state in which the delivery was made.[37]

(c) Position of Law for the period from September 7,1955 to September 10,1956.

The Sales Tax Validation Act,1956 covered the period only upto September 6,1955. Hence for the period commencing from September 7,1955 even explanation sales and non-explanation sales[38] could not be taxed by the states.

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35. cf. Ben Gorm Nilgiri Planatations v. Sales Tax Officer, A.I.R. (1964) S.C.1752,1756. The same transaction of sale of tea by auction to exporters was attempted, without success, to be brought within the expression "sale in the course of export" in Art.286(1)(b).
36. A.I.R.(1968) S.C.599,607.
37. Madras v. Habibur Rehman & Co., A.I.R.(1968) S.C.339; Bengal Timber Trading Co. v. Commr. Sales Tax, A.I.R.(1967) S.C.1348; Singareni Collieries v. Commr., Commercial Taxes, A.I.R.(1966) S.C.563,568.
38. See A.V.Thomas & Co. v. Dy.Commr., Agri.I.T.& Sales Tax, A.I.R. (1964) S.C.569.

(d) Position of Law for the Period from September 11,1956 to January 5,1957.

The next crucial date is September 11,1956 when the Constitution(Sixth Amendment) Act came into force.This Amendment Act did away with the explanation,to cl.(1)(a) of Art.286 and for Sub-clause(2) and (3) of Art.286 the new sub-clause were substituted. Sub clause(2) reads as follows:

"(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)".

This is to say by the amended sub clause(2) of Art. 286 the Parliament assumed the power to lay down principles for determining when a sale or purchase of goods takes place 1) out-side the state and (2) in the course of import into or export out of the territory of India and (3) the principles to ascertain who should tax such transactions.For this purpose the Amendment Act added entry 92-A[39] to List 1 of the SeventhSchedule and suitably amended entry 54[40] of List II.By virtue of these powers Parliament enacted the Central Sales Tax Act,1956 which

39. Entry 92-A reads"Taxes on the sale or purchase of goods other thana newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.
40. The following words were added to entry 54" subject to the provision of entry 92-A of List 1".It has-been observed "The amendment may be good from the stand point of convanience and integrity of the country, but it has tightened the economic grip of the Union over the States" K.Subba Rao Some Constitutional Problems(1970) Bombay),p.44.

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came into force on January 5,1957. So the position remained that for the period September 7,1955 to January 4,1957, inter-state sale or purchase was not subject to state taxation.[41]

(e) Position under the Central Sales Tax Act,1956.

Central Sales Tax Act was enacted to formulate principles for determining when a sale or purchase of goods takes place in the course of inter-state trade or commerce or outside a state. For this the term inter-state sale had to be defined and also the locale of the sale for the purpose of defining the respective jurisdiction of states.[42] Section 3 of the Act provided that there must be a movement of goods from one state to another in connection with a sale of that[43]

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41. See State Trading Corporation v. Mysore A.I.R.(1967) S.C.585,586-58

42. Section 3 reads" A sale or purchase of goods shall be deemed to take place in the course of inter-State trade or commerce if such 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 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".

43. Prem Piyari Aggarwal v. Punjab,A.I.R.(1967) Punj.130,131 (a sale by V.P.P. to a person in another state was held to be an inter-state sale.).

property in goods should pass during the movement of goods from one state to another by transfer of documents of title thereto.[44] It has been held[45] that inter-state sales contemplated by Art.286 (2) before the Sixth Constitution Amendment were the same as those defined in Section 3(3) of the Central Sales Tax Act. Mere contemplation of movement is not enough, there must be an actual movement of goods immediately after the sale and for that purpose even a subsequent export by the buyer also would not help.[46] The modus operandi of the transport did not determine the character of sale. For example, in Commr., of Sales Tax, Indore v. Allwyn Cooper,[47] there were two contracts for supply of manganese ore and in the first the price was f.o.r. pay - able at a railway station in Madhya Pradesh and in the other the price included the railway freight. Since the manganese ore was taken in the first case to state of Maharashtra and in the second case to State of Andhra Pradesh, the Supreme Court held the sales to be in the course of inter-state trade as the contracts necessarily involved movement of goods. The fact that title in goods passed inside the state where goods were situate does not make any difference in this matter.[48]

44.Tata Iron & Steel Co. v.S.R.Sarkar,A.I.R.(1961) S.C.65,71.
45.See Cement Marketing Co. v.Mysore,A.I.R.(1963)S.C.980,984.
46.See Mysore v.G.Thimmappa,A.I.R.(1967) S.C.1131,1133; E.Narasimham v.Orissa,A.I.R.(1961) S.C.1344,1345.
47.(1970) 25 S.T.C.26.(Supreme Court).
48.See P.B.Mukherji,J., in Dhirajlal Mehta v.Commr.,Commercial Taxes, A.I.R.(1963) Cal.442,455.

The phrase that the sale should occasion the movement of goods from one state to another would necessarily exclude a sale by a dealer if he takes the goods to the other state and sells there.[49] In such a case the inter-state character is not present as the movement is much before the sale in point of time. In Tata Eng.& Locomotive Co. v. Asst.Commr., Commercial Taxes,[50] the appellant, a manufacturer of trucks and buses, maintained stockyards in different states and after manufacture in the state of Bihar moved the vehicles to the stockyards in other states. Actual sales were effected in these stockyards and it was held that the sales were not interstate sales. But the position would be different if a contract was subsisting even though it matured into sale after the movement. For example, such a situation could arise if the contract of sale provided for approval or weighment by the buyer in the other state and in such a case even though the movement was before in point of time it has been held[51] that the sale was one of inter-state character.

49. Tamilnadu v. Cement Distributors(P) Ltd., A.I.R.(1975)S.C. 1142; Kelvinator of India Ltd. v. Haryana, A.I.R.(1973) S.C. 2526.
50. A.I.R.(1970) S.C.1281. In a later decision Bihar v. Tata Eng.& Locomotive Co., A.I.R.(1971) S.C.477,481 it was held that where under a contract of sale the buyer had to move goods from the state of purchase, it was still an inter-state sale.
51. Hanuman Mining Corpn.Ltd. v. Commr., Sales Tax,(1970) 25 S.T.C.60.(Supreme Court).

Section 4 of Central Sales Tax Act[52] provides for the situs of a sale by defining an "inside sale"and providing that such a sale should be deemed to have taken place outside all other states. Section 4(2) fixes the situs of sale with reference to time at which certain events take place or facts are to be found.[53] It is the state where the goods are situate in the case of specific or ascertained goods and in the case of unascertained or future goods the state where such goods are situate at the time of their appropriation to contract of sale.[54] So if in a case such appropriation of unascertained or future goods occur in a different state, only that particular state can claim the sale to be an "inside sale".

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52. Section 4 reads(1) Subject to the provisions contained in Sec.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 States-(a) in the case of specific or ascertained goods, at the time when 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 places."

53. See Ashok Leyland Ltd. v. Madras, A.I.R.(1968) Mad.348,349.

54. In the case of unascertained goods title in goods does not pass until ascertained. See Commr.of Sales Tax. v. Husenali Adamji & Co., A.I.R.(1959) S.C.887,893.

So if on application of Section 3 a sale is found to be of inter-state character, Section 4 comes into play to fix the situs of sale. Under Section 7 every dealer liable to pay tax under Section 6, which is the charging section of the Act, has to register in the "appropriate state". The term" appropriate state"[55] is defined to mean the place where the dealer has his place of business and if he has places of business in different states, every such state. Section 8 provided for the rates of tax on inter state sales.[56] In 1958 the old Section 8 was substituted by a new one by Central Sales Tax (Second) Amendments Act,1958. Under the new section if the sale to a government or to a registered dealer is of certain goods specified in S.8(3) the rate of tax was only three per cent. In all other cases the rates of tax were as follows:-(1) in the case of declared goods[57] the same rate as is levied under

55. Section 2(a).

56. In Mysore v. Lakshminarasimhiah, A.I.R.(1965) S.C.1510 it was held that the old Section 8 provided for levy of tax in the same manner as in the concerned sale tax legislation of the state. Since the transaction was exempt from tax under the law of the State, it was held to be exempt under the Central Sales Tax Act also. Shah, J., dissented.

57. Declared to be of special importance in inter state trade or commerce under S.14 of the Act, S.15 lays down two conditions on taxation of such goods namely, that the rate ought not to exceed 3% and that tax ought not to be levied at more than one stage on such commodities.

the sales tax law of the appropriate state and (2) in the case of other goods at the rate of ten per cent or the respective the sales tax law of the appropriate state and (2) in the case of other goods at the rate of ten per cent or the respective rate of tax under the sales tax law of the appropriate state applicable to such goods, whichever is higher. Thus it could be seen that the general rate of tax under Central Sales Tax Act is ten per cent. Sub Section 2-A enacts a proviso to this sub-clause. Under this sub-section if the sale or purchase of any goods is exempt generally[58] under the respective state sale tax law, no tax is payable under the Central Sales Tax Act also. Further if the rate of tax in relation to any goods is lower than three per cent under the respective sale tax law of the state only such lower rate need be paid under the Central Sales Tax Act.

<u>Restrictions Under Art.286(3)</u>

Art.286(3) before amendment in 1956 reads as " 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

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58. Means that such goods are not exempted only under specified circumstances or specified conditions etc. See explanation to S.8 (2A).

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". By this clause the Constitution puts another restriction on the power of states to impose sales tax even on intra-state sales of certain commodities. In Indore I & S.R.S.Assn. v. Madhya Pradesh,[59] it was held that that clause applied only to a state law enacted after the Constitution as the office of the President was created by the Constitution and that such state law must come later to the declaration contemplated by the Constitution. The Parliament enacted Essential Goods(Declaration and Regulation of Tax on Sales or Purchase) Act,1952 declaring certain category of goods essential for the life of the community. In Punjab v. Sansari Mal,[60] it was held that the non compliance as to assent of President would make the imposition of tax on such commodities a nullity.

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59. A.I.R.(1962) S.C.191,194. It was held that the sub-clause (3) to Art.286 did not apply to a pre constitutional law; see also Soma Singh v.Pepsu, A.I.R.(1954) S.C.311; Gowrishankar v.Sales Tax Officer,A.I.R.(1958) S.C.883. It is submitted that the view expressed is wrong as the intention behind the provision was to attain certain uniformity in state laws with respect to the matter.
60. A.I.R.(1968) S.C.331,336. Though the charging section was of a general nature, it was held that that could not affect the sale of declared goods.

The Constitution Sixth Amendment Act substituted a new sub clause(3) [61]. It has been held that such repeal brought into effect legal provisions which were ineffective because of the old subclause(3). The amended sub-clause(3) reads" 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 by law specify". Sections 14 and 15 of Central Sales Tax Act,1956 were the provisions enacted by Parliament in this behalf.Section 14 enumerated the list of articles of special importance in inter-state trade or commerce.Section 15 provided that the rate of tax on sale of such articles should not exceed three per cent and that such tax should not be levied at more than one stage.The section also provided that if tax was already levied inside the state on such articles, any tax levied on inter-state sale of such articles ought to be refunded.

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61. Punjab v.Sansari Mal,A.I.R.(1968)S.C.331,336.

In Modi Spg. & Wvg.Mills Co. v. Commr.,Sales Tax, Punjab,[62] it was held that the effect of amended Art.286(3) on charging Sections of state sale tax laws which are inconsistent with section 15 of Central Sales Tax Act was not to destroy such charging sections but only to modify them in accordance therewith. The mere imposition of additional excise duty under Additional Duties of Excise(Goods of Special Importance) Act,1957 was held not to affect the jurisdiction of states to impose sales tax.

Sales Tax On Foreign Commerce.

Art.286(i)(b) provided that no law of a state should impose or authorise the imposition of tax on the sale or purchase taking place in the course of the importamt of the goods into or export of the goods out of the territory of India.[63] In Travancore-Cochin v. Bombay Co. Ltd.,[64] the Supreme Court of India had to consider a case where title in goods had already passed to the foreign buyer before the journey of goods

62. A.I.R.(1965) S.C.957,961. In Bhawani Cotton Mills v. Punjab, A.I.R.(1967) S.C.1616 the Supreme Court by a majority held that the Punjab Sales Tax Act did not specify the point of taxation of purchase of cotton, which was one of the declared goods. Such absence of specification, it was held, would result in multiple taxation of declared goods and was held to be invalid.
63. In 1956 the Constitution(Sixth Amendment) Act provided for enactment by Parliament to lay down the principles to determine where a sale or puchase took place in the course of import or export. See Section 5 of Central Sales Tax Act,1956.
64. A.I.R.(1952) S.C.366.

began. Sastri,C.J., speaking for the Court held that a sale by export involved a series of integrated activities commencing from the agreement of sale with a foreign buyer and ending with the delivery of goods to a common carrier for transport out of the country by land or sea. Such sale and the resultant export were held[65] to from part of the same transaction. In order to fall within the ambit of Art.286(i)(b), it was held that the sale or purchase should itself occasion the export or import of goods.The transaction in the instant case was held to be one falling under Art.286(i)(b). This a meant that the sale of goods to a foreign buyer should be coupled with actual setting in motion of gooos. This view necessarily excludes a local sale to an exporter who subsequently exports it,[66] or even a sale to a foreign buyer who later moves the goods out of country.[67] The view that local purchases for the purpose of export is notcovered by Art.286(i)(b) was reinterated in Madras v. Gurviah Naidu.[68]

65.Ibid at 367-368.

66.Travancore Cochin v.S.V.C.N.Factory,AiI.R.(1953) S.C.333,336. The respondent importeo cashew nut from East Africa through commission agents.Though this was held to be exempted from taxation, the other category of purchase of cashew nut from "Bombay party" which they had imported, was held to be liable to tax.The reasons given for excluding the last purchase for the purpose of export were(a) there could be no double taxation and (b) the last seller who is liable to pay the tax might not even know whether goods were in fact exported. See also Das, J., Ibid at 348-351.

67.Ben Gorm Nilgiri Plantation Co. v.Sales Tax Officer,A.I.R. (1964) S.C.1752.

68.A.I.R.(1956) S.C.158;161; M.M.Mohideen Thumby & Co. v. Madras A.I.R.(1962) Mad.323,325.

In cases of export sales, it is necessary that the sale and journey of goods out of India should be one integrated transaction.[69] Chagla, C.J., observed that one test which was fairly simple, easy and almost infalliable was to consider whether the exporter could have diverted the goods which he had purchased to any purpose other than the purpose of export. In Ben Gorm Nilgiri Plantation Co. v. Sales Tax Officer,[70] tea was sold in auction along with export quota and the question was whether the sale by auction to the agent or intermediary of the foreign buyer who later sends the goods out of India was one in the course of export under Art.286(i)(b). Shah, J., speaking for the majority observed that mere intention to export though followed by actual export would not constitute a sale in the course of export.[71] It was held that there must be also an obligation to export which might be statutory, contractual, arising from mutual understanding, agreement or from the nature of the transaction. In the instant case, it was

69. Daulatram Rameshwarlal v. B.K.Wadeyar, A.I.R.(1958) Bom.120,122.
70. A.I.R.(1964) S.C.1752.
71. Ibid at 1755. Wanchoo and Ayyangar, JJ., dissented and held that on the facts of the case the buyer was bound to export the tea. Ibid at 1761. It follows that if a foreign buyer comes over to India, purchases the goods in the local market and later takes back to his own country, the transaction would be liable to sales tax. Shankerlise Raut. v. Bihar, A.I.R.(1968) Pat.329. In National Carbon Co. v. S.T.Commr., A.I.R.(1969) All.205,209 it was held that even though goods were taken delivery of inside India by the foreign buyer that would not detract from the inter-state character of the sale.

held that the purchaser was under no obligation to export even though he might export it. Wanchoo and Rajagopala Ayyangar,JJ.,[72] dissented and held that though no contract for export existed an implicit understanding to that effect was not ruled out. The buyer was only an agent of foreign purchaser and was not free to deal with the goods.

It is submitted,that the majority view is too technical and lays much stress on the form of contract rather than substance.The Constitution only uses the term "sale in the course of import or export of goods" and does not say that it should be under a contract which provides for export of goods.[73] The issue was again brought before the Supreme Court in Coffee Board, Bangalore v. Jt.Commercial Tax Officer.[74] Here the Coffee Act,1942 prohibited theexport of coffee otherwise than by the Board or under its authorisation. The Board sells select coffee for export to registered exporters. The registered exporters were bound to sell such coffee to foreign buyers.As could be seen the facts of this case are different and the auction sale can by no stretch of imagination be termed as one in the course of export. In Ben Gorm Nilgiri Plantations Co. v. Sales Tax Officer,[75] the buyers were agents of foreign

72.Ibid at 1761.
73.See S.K.Roy, v. Addl.Member, Board of Revenue,A.I.R.(1967) Cal.338,345(D.Basu,J.).
74.A.I.R.(1971) S.C.870.
75.A.I.R.(1964) S.C.1752,1754.The question posed was "is the sale by auction to the agent or intermediary of the foreign buyer, in the course of export within the meaning of Art.286(i) of the Constitution".

purchasers while in Coffee Board case the buyers were at best prospective export sellers. It is submitted that the mere fact that there is no contract between the seller and foreign buyer should not be conclusive of the matter.[76]

With regard to import of goods into India from foreign countries the same test is applied. In the leading case of K.G. Khosla & Co. v. Dpty.Commr.Commercial Taxes,[77] the facts were as follows. The appellant entered into a contract with a government department for the supply of axle box bodies. The said goods were manufactured in Belgium after inspection and under directions from the agent of the buyer, namely the government department. The appllant was responsible for the safe arrival of the goods at the destination in India. Sikri, J., speaking for the Court held that under the contract between the assessee and the government department it was provided that axle box bodies would be manufactured in Belgium and delivered in India.[78] It was also held that there was no possibility of these goods being diverted by the assessee for any other purpose.

76. See S.K.Roy v. Addl.Member, Board of Revenue, A.I.R.(1967) Cal. 338,345.

77. A.I.R.(1966)S.C.1216. In Dy.Commr.,Agri.Income Tax And Sales Tax v. Kotak & Co., A.I.R.(1973) S.C.2491,2494 the respondent firm utilised the import licenses obtained by certain mills to supply foreign cotton to such mills. It was held that the respondent was acting as an agent and that the sale to the mills occasioned import of cotton under Art.286(i)(b).

78. Ibid at 1220. Why this aspect is stressed is difficult to understand. Probably an import license was obtained by the assessee on this footing and on the recommendation of the buyer department. Even in such a case it is no practical impossibility to divert goods though the assessee may be subject to other penalties. The decision was approved as correct by the Law Commission Of India. See Thirteenth Report (1967), p.65.

It is clear that even if there was a prior sale by the Belgium manufacturer to the assessee, it was over a in Belgium and beyond the jurisdiction of the sales tax authorities. Recently in Binani Brothers v. Union of India,[79] the petitioner imported non-ferrous metals from foreign countries in order to fulfill the contracts between the petitioner and the government department. The Government of India, while placing orders with the petitioner used to grant import licenses in terms of the contract.[80] The court held that the purchase of the goods by the petitioner from the foreign sellers had occasioned the import of goods and the sale by the petitioner inside India was held to be liable to sales tax. The Court rejected the contention based on the fact that the import license was procured at the instance of the department solely for the supply of goods under the contract, as the Court found that there was no absolute obligation on the department to procure those facilities.

The legislative induction of the State Trading Corporation into certain export and import agreements has further complicated the situation as illustrated by the decision in Mod. Serajuddin v. Orissa.[81] There the appellant had negotiated a sale with foreign buyers for sale of mineral ore. In order

79. A.I.R.(1974) S.C.1510. The case came before the Supreme Court as an original petition under Art.32 of the Constitution when the Government took the view that no sales tax was payable and attempted to realise that paid earlier from the petitioner.
80. Ibid at 1515.
81. A.I.R.(1975) S.C.1564.

to satisfy the legal requirements under Export Control Order, 1958 two contracts were entered into, one between the appellant and the State Trading Corporation and the other between the State Trading Corporation and the foreign buyer. Even though apparently two contracts existed the State Trading Corporation was only entitled to a commission of one dollar per ton of ore supplied by the appellant.[82] The majority of the Court[83] held that the Corporation was the exporter and under the contract the appellant had no rights whatsoever against the foreign buyer. The sale was held to be taxable under the sales tax Act. His Lordship Justice Khanna dissented. According to his lordship the two sales were so interconnected as to be part of one integrated transaction.[84] It was pointed out[85] that the contract being f.o.b. there was absolutely no chance of diversion of the goods by the State Trading Corporation. The real issue, it is submitted, was whether there were two sales at all. Khanna, J., pointed out that though there were two contracts for sale there was only one sale. That is to say, the State Trading Corporation was not a purchaser in the ordinary sense of the term but only a "statutory intermediary".[86] The sale, if any, was only fictitious as the price was paid by the foreigner buyer only. It is true, that the State Trading Corporation was no agent of

82. The contract of sale was f.o.b. The sale price to be assigned by the State Trading Corporation to the appellant.
83. Ray. C.J., Mathew, Beg & Chandrachud, JJ.
84. Ibid at 1582.
85. Ibid at 1584.
86. Ibid at p.1584. The State Trading Corporation was not entitled to profits or liable for losses, could not resell or retain the goods but was only entitled to a commission.

the appellant as held by the majority[87] but that need not have resulted in a finding that there was a sale liable to tax when there was only an agreement of sale. The decision has been followed in Punjab v. New Rajasthan Mineral Syndicate.[88] The facts of the case were wholly different,[89] as a procurring agent of the State Trading Corporation had entered into the contract for procurring iron ore with the respondent. The ore had to be delivered at an Indian port and money was payable in India. So here there were two sales, the sale by the respondent, being one for export only, was exigible to sales tax.

An earlier decision of the Supreme Court in National Tractors, Hubli. v. Commr., Commercial Taxes,[90] had considered this problem from a different angle. The facts were that the assessee had purchased iron ore and sold them to the State Trading Corporation for export to foreign countries. The contracts were f.o.b. and price was payable in two portions, one when the shipment was made and the other against the certificate of weight and analysis at the foreign port of discharge. Under the Mysore Sales Tax Act in cases of sale of iron ore the last purchaser within the State was liable for tax. So the issue before the Supreme Court was also who was the last purchaser before export-the assessee or the State Trading Corporation. In other words if the sale by the assessee to the State Trading

87. Ibid at p.1574.
88. A.I.R. (1975) S.C.1652.
89. Though the Court held" be that as it may, the basic features of the case in hand are the same as those in Serajuddin's case" Ibid at 1659.
90. A.I.R. (1971) S.C.2277.

Corporation was a sale for export, the Corporation would have been liable to tax and if such sale was in the course of export, assessee would have been liable for the purchase he had made.The Court held that the contracts between assessee[91] and S.T.Corporation were f.o.b. and the normal rule in such contracts was that the property was intended to pass on the shipment of goods and it was held that the assessee was the last purchaser liable to tax.This is effect meant that the sale of iron ore by the assessee to the Corporation was one in the course of export not liable to taxation. However, this decision was distinguished by the majority in Mod.Serajuddin v. Orissa,[92] as one dealing with the question as to who was the last purchaser within the State and not one relating to whether the sale to the Corporation was in the course of export.

The position of law emerging from the above discussion is that the matter is completely dependant on the terms of the particular contract of sale.The sale or purchase will be exempt only in cases where it is able to prove that the buyer in the case of an export and the seller in the case of an import was only an agent of the foreign buyer or seller respectively.

91.Ibid at p.2279.
92.A.I.R.(1975) S.C.1564,1575(Ray,C.J.).

The time of transfer of property in goods, whether before or after the goods started movement is immaterial and it seems immaterial[93] that the foreign buyer is unknown even after shipment of goods.[94]

In Burman Shell O.S.& D.Co. v. Commercial Tax Officer,[95] the sales of aviation spirit to air crafts bound to foreign countries was held not a sale in the course of export. It was held that in the case of an export sale, the goods must have a foreign destination. Here the oil was consumed by the buyer himself. The same view was followed[96] where coal was supplied to ships bound to foreign countries as fuel.

It has been held that goods in the course of transit when transferred come within the ambit of Art.286(i)(a). In J.V.Gokal & Co. v. Asst.Collector, Sales Tax,[97] the goods were in

93. K.G.Khosla v. Dy.Commr., Commercial Taxes, A.I.R.(1966) S.C.1216, 1220; B.K.Wadeyar v. Daulatram Rameshwarlal & Co., A.I.R.(1961) S.C.311,313; Travancore-Cochin v. Bombay Co., A.I.R.(1952) S.C.366,368.

94- For a contrary view see Haji Abdul Wahab v. Govt.of Madras, A.I.R.(1962) Mad.250.

95. A.I.R.(1961) S.C.315. See also Depty.Commr.Commercial Taxes v. Caltex (India) Ltd., A.I.R.(1962) Mad.298.

96. See Kerala v. CochinCoal Co., A.I.R.(1961) S.C.408.

97. A.I.R.(1960) S.C.595,599; Travancore Cochin v. S.V.C.Factory, A.I.R.(1953) S.C.333,338.

the high seas when transferred to the Government of India. It was held that the course of import started at a point when the goods crossed the customs barrier of the forign country and did end at a point in the importing country after the goods crossed the customs barrier. A purchase of such goods while in high seas or a sale by an importer by transfer of documents was held to be sale or purchase in the course of import.[98]

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98. See Shivrattan G.Mohatta, v.S.T.O.,Jodhpur,A.I.R.(1964) Raj.5,10. A sale after the arrival of goods in harbour is liable to tax .See Madras v.Davay & Co.,A.I.R.(1970) S.C. 165,168.

PART FIVE

INTERGOVERNMENTAL TAX IMMUNITIES.

CHAPTER XVI

INTER GOVERNMENTAL TAX IMMUNITIES.

In a federation the two tier system of governments operating in the same territory often brings about the complicated problem of one government exercising its taxing power to restrict or limit the activities of the other. This would necessarily follow if each government is allowed to tax the activities of the other as every tax is in some measure regulatory.[1] Chief justice Marshall of the United States Supreme Court enunciated the doctrine of immunity of instrumentalities in the celebrated case of McCulloch v. Maryland,[2] to hold that the states have no power, by taxation or otherwise, to retard, impede, burden or in any manner control the operations of the constitutional laws enacted by Congress to carry into execution the power vested in the general government. Marshall,C.J.,had laid down the doctrine as a necessary implied power in a federal constitution.[3] The benefit of this doctrine was extended to the instrumentalities of the states as well, later.[4]

1.See Sonzinsky v. United States,(1937) 300 U.S.506,513(Stone,J.).
2.(1819) 4 Wheat.316,436. It was held that the federally incorporated Bank of the United States was immune from discriminatory state taxation on its issuance of bank notes.Followed in 1829 to invalidate a tax on United States bonds owned by a tax payer in Western,Et.Al.v.City Council of Charleston (1824)1 Wheat.738.
3.See objections on this score of implied powers,In Australia Isaacs,J., in Amalgamated Society of Engineers v.The Adelaide Steam Ship Co. Ltd.(1920) 28 C.L.R.129,155"The doctrine of "implied prohibition" finds no place where the ordinary principles of construction are applied so as to discover in the actual terms of the instrument their expressed or necessarily implied meaning".
4.Buffington v.Day,(1870) 11 Wall.113.It was held that the pay of officers of state administering laws was immune from federal taxation.

Marshall,C.J., had laid down the doctrine in a case of discriminatory and destructive state taxation of a federal instrumentality and the application of general tax immunity was a later innovation.The initial development and application of the doctrine was in the area of taxation of the salary of the employees of the federal government and vice versa.[5] But this application of the doctrine to protect the salary of civil servants has been discarded subsequently.[6] This change of attitude of the courts was the result of the realisation of the fact that a tax by one entity should not be held invalid by the mere fact that the ultimate economic burden of such tax is borne by the other government.[7] [8] The initial flourish of this doctrine in the United States of America was later attempted to be curtailed and confined into its proper area.[9]

5.In Australia see D'Emden v.Pedder(1904) 1 C.L.R.91 and Deakin v.Webb,(1904) 1 C.L.R.585.
6.In U.S.A. see Graves v.New York,(1939) 306 U.S.466. In Australia see West v.Commissioner of Taxation,(1937) 56 C.L.R. 657. In Canada see Caron v.The King,(1924) A.C.999, Forbes v. A.G. for Manitoba,(1937) A.C.260.
7.This view has been applied in the case of sales-tax on materials purchased by a government contractor in Alabama v. King & Boozer,(1941) 314 U.S.1, 8.
8.See Long v.Rockwood,(1927) 277 U.S.142 where a state tax on royalties from patent was struck down on the ground that such patent was issued by the Federal Government. It was overruled in Fox Film Corpn. v.Doyal,(1932) 286 U.S.123.
9.See T.R.Powell,"The Waning of Intergovernmental Tax Immunities"(1945) 58 Har.L.Rev.633.

In India, the first attempt to form a federal set up was made by the Government of India Act,1935 and the provisions of the same may be examined to understand the scope and extent of the application of the doctrine in India.Sections 154 and 155 of the Government of India Act,1935 were as follows:

S.154."Exception of certain public property from taxation.Property vested in His Majesty for purposes of the government of the Federation shall, save in so far as any Federal law may otherwise provide, be exempt from all taxes imposed by, or by any authority within, a Province or Federal State: Provided that until any Federal law otherwise provides, any property to vested which was immediately before the commencement of Part III of this Act liable, or treated as liable, to any such tax, shall, so long as that tax continues, continue to be liable or to be treated as liable, thereto".

S.155"Exemption of Provincial Governments and Rulers of Federated States in respect of Federal taxation.1) Subject as hereinafter provided, the Government of a Province and a Ruler of a Federated State shall not be liable to Federal Taxation in respect of lands or buildings situate in British India or income accruing, arising or received in British India:

Provided that -- a) where a trade or business of any kind is carried on by or on behalf of the Government of a Province in any part of British India outside that Province... nothing in this subsection shall exempt that Government.......

from any Federal taxation in respect of that trade or business, or any operations connected therewith, or any income arising in connection therewith, or any property occupied for the purpose thereof;............"

Under S.154 only the property vested in the Crown for the purpose of the government of the federation was exempt from provincial taxation.This did not apply to property vested in federal instrumentalities such as public corporations created by Federal Legislature. Secondly, Section 154 exempted such property from all taxes imposed by a province. Whether the term "all taxes" refers to property tax alone or to other taxes such as sales tax also, which are imposed on other incidents, is not clear. However, property which was liable or treated as liable to provincial or local taxation before 1.4.1937 would continue to be liable till the Federal Legislature made any law to the contrary.

The meaning of the word' property' used in S.154 was the subject matter of a decision by the Federal Court of India in Corpn. of Calcutta v.Governors of St.Thoams School.[10] Here the Government of India had requisitioned private property under the Defence of India Rules and had also erected additional structures in that property.Tho question raised before the Court was whether such additional structures put up by the Government subsequent to the requisition was liable to tax as not being

10.A.I.R.(1949) F.C.121.

"property" vested within the meaning of S.154. It was held[11] that S.154 used the term property in that context without any limitation and therefore should bear its normal meaning and will embrace every kind of property. It was held that the additional structures put up by the Government was "property" and was exempt from local taxation. From the above decision it seems that if Government acquires private property which was liable to taxation prior to such acquisition, then the liability to such taxation continues even in the hands of the Government. In such cases the liability will fasten only on the land and existing structures at the time of acquisition and not on any new structure put by the government after acquisition.[12] This is because such property was not in existence before 1.4.1937 and was not liable to taxation. On a parity of reasoning it would follow that if property which was liable to taxation before 1.4.1937 was demolished the liability also ceases. So also the tax which was imposed before 1.4.1937 should continue in the same form though the rate may be

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11. Ibid at 124. An observation by Langdale, M.R. in Jones v. Skinner, (1835) 5 L.J.Ch.87,90" Property is the generic term for all that a person has dominion over. It is most comprehensive of all terms which could be used, in as a much as it is indicative and descriptive of every possible interest which property can have" was cited with approval.
12. See G.G. in Council v. Corporation of Calcutta, A.I.R.(1948) (1948) Cal.116,119.

varied.[13] The expression "treated as liable" had been used to cover cases where it might have been open to the Crown to have contended that such taxes as had in fact been collected before 1.4.1937 were not in fact legally enforceable.[14]

Under S.155 of the Government of India Act,1935 the provinces were exempt from federal taxation so far as land, buildings and income were concerned. But this exemption did not extend to any stock in trade or any trade or business or any income derived therefrom carried on by a province outside that province. Hence it follows that if a province carried on any business or trade inside that province, the stock in trade and income of such business were exempt from federal taxation. Further, the Government of India Act,1935 did not prohibit taxation by one province of the property,income or activity of another province. But it was not clear whether the property and income of a local authority was free from federal taxation. Strictly sepaking,S.155 only exempted the government of/province or rulers of federated states, and local authorities were outside the protection of S.155.

13.Mukherjee, J., in G.G. in Council v.Corporation of Calcutta, A.I.R.(1948) Cal.116, 120. See also Bellary Municipality v. Union of India A.I.R.(1970) Mys.37,42; Union of India v. Municipal Bd.,A.I.R.(1957) All.452,455.For contrary view Revelganj Municipality v. N.E.Rly,A.I.R.(1970) Pat.374,377.
14.A.I.R.(1948) Ca.116,122(Ormond,J.).

The Constitution of India adopted the aforementioned provisions with certain changes in Articles 285 and 289. They read as follows: "Art.285. Exemption of property of the Union from State taxation:-(1) The property of the Union shall, save in so far as Parliament may by law otherwise provide, be exempt from all taxes imposed by a State or by any authority within a State.

(2) Nothing in clause(1) shall, until Parliament by law otherwise provides, prevent any authority within a State from levying any tax on any property of the Union to which such property was immediately before the commencement of this Constitution liable or treated as liable, so long as that tax continues to be levied in that State".

"Article 289. Exemption of property and income of a State from Union taxation:- (1) The property and income of a State shall be exempt from Union taxation.

(2) Nothing in clause(1) shall prevent the Union from imposing, or authorising the imposition of any tax to such extent if any, as Parliament may by law provide in respect of a trade or business of any kind carried on by, or on behalf of, the Government of a State, or any operations connected therewith, or any property used or occupied for the purposes of such trade or business, or any income accruing or arising in connection therewith.

3) Nothing in clause(2) shall apply to any trade or business, or to any class of trade or business, which Parliament may by law declare to be incidental to the ordinary functions

of government."

Art.285 is exactly similar to S.154 of the Government of India Act,1935. The draft Article 264(which was later enacted as Art.285 Cl.(i) read as follows "The property of the Union shall be exempt from all taxes imposed by a State or by any authority within a State". Since cl.(2) only protected existing taxation at the commencement of the Constitution,it was apprehended that no new tax could be imposed on Union property.

Hence it was provided by an amendment viz.,"save in so far as Parliament may by law otherwise provide" empowering Parliament to enable such local authorities which had not taxed before.[15] It is clear that Art.285 will exempt the property belonging to a federal instrumentality only if it is proved that such property vests in the Union Government. Such a contention will not stand if such federal instrumentality is a public corporation having separate legal personality. Under Art.285 the Parliament has no power to confer immunity on such authorities from state or local taxation.The only power given under Art.285 is to release any property which was hitherto not liable to state or local taxation, to such taxation. In this aspect the Indian Law is different from the positionaf of law obtainable in U.S.A., where the federal legislature can

15.See D.R.Ambedkar,C.A. Debates. Vol.IX p.1159. The amendment was made at the instance of R.K.Sidva, who was the President of the Local Authorities Union.

confer such immunity from taxation on any instrumentality and the Constitution contains no limitation on this federal power.[16]

Under Art.285 the property of the Union Government is exempt from state taxation unless such property was subject to taxation at the time of the commencement of the Constitution. Property which was under private ownership till March 31,1943 and for which the tax was continued to be paid by the Central Government till the commencement of the Constitution was held to be property" treated as liable" within the meaning of Art. 285.[17] The only limitation in such cases is that the nature of the tax should not be altered though the rate of the tax can be varied.[18] It has been held that the lessee of property belonging to the Union Government may be taxed so far as the value of the lease hold interest is concerned.[19] In the converse case

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16. See Frankfurther,J., in U.S. v. County of Alleghany,(1944) 322 U.S.174,196 that the exemption under a congressional statute might go further than constitutional immunity.See also Dameron v. Broadhead,(1952) 345 U.S.322,325 (Prohibition on state taxation of army personnel except by state of domicile).
17. Corporation of Calcutta v. Union of India, A.I.R.(1957) Cal.548,550.
18. Turf Properties Ltd. v.Corporation of Calcutta,A.I.R.(1957) Cal.431,437. In U.S.A. See Offutt Housing Co. v.Sarpy, (1955) 351 U.S.253. In Australia see A.G. for Queensland v. A.G.for Commonwealth,(1915) 20 C.L.R.148. In Canada see City of Montreal v.A.G. for Canada(1923) A.C.136(P.C.).
19. The interest of a lessee consists in the benefit of the occupation to him during the period of his occupancy and and does not depend upon the length of his tenure. Lord Parmoor in City of Montreal v.A.G. for Canada,(1923) A.C. 136, 142-143.

the fact that the Union Government is the lessee of the property[20] would not exempt the owner from taxation by a state even if such owner passes such liability to his tenant. A tax levied upon the interest of a person in the property belonging to the Union Government should not be invalidated because of the omission to specify that the tax is on the privilege of using or possessing such property and to take a contrary view has been held to be a victory for empty formalism.[21] If the prohibition under the Constitution is only that such taxation should not be enforced against the property of the Union Government as such, it is submitted that the courts should not take exception[22] even to tax by a state on the full value of the property as against the value of the interest of the lessee. That is to say, that so long as a state does not profess or attempt to enforce the tax against the property of the Union Government, but only realises the tax from the lessee[23] or the person in beneficial enjoyment of such property, the tax if not discriminatory, has to be upheld. It is also clear that the fact that the Union Government is in possession of private property or has extended control over a private

20. City of Halifax v. Fairbanks Estate (1928) A.C.117.
21. Black J., in City of Detroit v. Murray Corpn., (1958) 355 U.S.489,493.
22. In Turf Properties Ltd v. Corporation of Calcutta, A.I.R. (1957) Cal431 the Court issued a writ of mandamus as the statute only provided for a consolidated rate of tax.
23. To what extent such measures can go is not clear. In a case from Canada, Duff, C.J., observed that it was wrong to infer that such taxation can in every case be enforced by remedies involving the sale or appropriation of the occupant's right without regard to the natureof the right" Spooner Oils Ltd. v. Turner Valley Gas Construction Board, (1933) S.C.R.629,645. See also City of Montreal v. A.G. for Canada, (1923) A.C.136,144.

trade or business, does not relieve such property from state taxation.

If property vests in the Union Government as a trustee such property would be exempt from property tax of a state whoever may be the beneficiary under the trust,[24] though such property might be subjected to estate duty or inheritance tax.[25] The enquiry by the courts in such cases as to the ownership[26] of the property seems rather unwarranted. For example, in Canada[27] in the case of Bennett & White(Calgary)Ltd. v. Sugar City,[28] the agreement between the Dominion Government and a contractor provided that all plants and materials should become and be the property of the Government until completion of the work, whereupon unused plant and materials should be deliverable to the contractor. The issue before the Privy

24. See a case from U.S.A. McCurdy v.United States,(1923) 264 U.S.484(lands held in trust by U.S.Government for the benefit of red indians).
25. See West v.Oklahoma Tax Commission,(1947) 334 U.S.717. In India states could impose estate duty only as regards agricultural property and there is at present no succession duty levied.
26. See Bennett & White (Calgary)Ltd. v.Sugar City,(1951) A.C. 786,819; S.R.A. v. Minnesota(1945) 327 U.S.558,565.
27. S.125 of the Canadian Constitution exempted both dominion as well as provincial property from mutual taxation.
28. (1951) A.C.786.The tax was invalidated.

Council was thus the ownership and legal possession of the property in order to find out the validity of a provincial tax on them. The same line of reasoning may be discerned in a decision of the U.S.Supreme Court in United States v. Country of Alleghenv,[29] where a lessee who installed government machinery on his own land was taxed on the full value of the equipment. Here although the value of the government machinery was taken into account in determining the tax, the liability really fell on the land belonging to him and the government machinery was in no way liable to tax. The U.S.Supreme Court got over this point by holding that if the land was sold out for collection of the tax from under the machinery, the effect on its usefulness to the Government would be almost as disastrous as to sell the machinery itself. But it is submitted that this argument has nothing to commend itself because the Constitution only envisaged the protection of the government from taxation with regard to its property and did not seek to protect private individuals using such property to make profits. The rule should be strictly confined to cases where property in the hands of the government is attempted to be taxed and where the tax charges such government property (i.e.,

29.(1944) 322 U.S.174,187; James v. Dravo Contracting Co., (1937) 302 U.S.134(a gross receipt tax on payments to a private contractor was upheld); Alabama v. King Boozer, (1941) 314 U.S.1(sales tax on materials purchased by a contractor for execution of a federal building project was upheld.), legal incidence and not the economic incidence) and a private individual should not/be allowed to seek protection behind the doctrine of immunity.[30]

The above mentioned line of argument is not m unmindful of the fact that Art.285 of the Constitution of India has granted exemption from taxation not to the Union Government but to the property of the Union Government. That is to say, the immunity is thatof the property and not of the Union Government and normally any tax in rem on such property is hit by the prohibition contained in the Constitution. But was it the intention of the constitution markers to incarnate such property and endow them with an immunity from state and local taxation discarding the Union government as a mere abstraction? In India the courts have not yet come to grips with this baffling problem and we have yet to see the stand which would be taken here in such matters.

The property of the railway[31] stands on a slightly different footing requiring a special mention here. S.135 of the Indian Railways Act,1890 provided that railway property would be subjected to a tax by any local authority only if the Governor General-in-Council by notification provided so. Under

30.cf.City of Detroit v. Murry Corporation of America,(1958)355 U.S.489 seems to be a decision on these lines.
31.Art.366(20) reads:"Railway does not include(a) a tramway wholly within a municipal area, or(b) any other line of communication wholly situate in one State and declared by Parliament by law not to be a railway". S.145 of the Railway Act,1890 provides for extension of the provisions of the Act to tramways also by the Central Govesnment. See General Manager B.B.Ligh Railway v. Municipal Commrs.of Bihar,A.I.R. (1968) Pat.59,60.

S.135 the Governor General-in-Council could also revoke or vary any existing notification authorising such taxation. This was the position till the Government of India Act,1935 came into force. S.154 of the Government of India Act,1935 provided for continuance of existing taxation. It was thsought that unless a new law was enacted railway property could not be made liable to fresh taxation by local authorities. Hence in 1941 the Railway(Local Authorities Taxation) Act was enacted. S.3 of the Act provided for a notification by Central Government to enable the local authorities to tax the property belonging to railway. The notifications empowering local authorities to tax railway property issued under S.135 of the Indian Railways Act,1890 was considered by the Supreme Court in <u>Union of India</u> v.<u>Sahibganj Municipality.</u>[32] Here the notification subjecting the railway property to taxation(house rate and latrine fees) was issued in 1911. The issue before the Court was whether certain buildings constructed after the commencement of S.154 of the Government of India Act,1935 and Art.285 of the Constitution of India were liable to tax under the aforesaid notification.[33] The Patna High Court had earlier

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32. A.I.R.(1973) S.C.1185. In <u>Union of India</u> v.<u>Lonavala Municipality</u>,A.I.R.(1971) S.C.211 a notification under S.135 of the Railways Act authorising the imposition of "tax on lands and buildings" was held to cover a consolidated tax on the property.

33. <u>Dominion of India</u> v. <u>Motihari Municipality</u>,A.I.R.(1954) PAT.568,575. In <u>Union of India</u> v.<u>Lucknow Municipality</u>,A.I.R.(1957) All.452 it was held that the amount of tax can be increased in accordance with the increase in value of property.

taken the view that a notification issued under the Indian Railways Act was enough to render the railway property, irrespective of its date of construction, liable to local taxation as the notification was of general nature and not in respect of any particular building or structure. The Supreme Court of India rejected this view and held that such notification only made the property then in existence liable to taxation. Whether a fresh notification under Railway(Local Authorities Taxation) Act, 1941 was sufficient to render such new buildings liable to taxation is not even clear from the judgement.[34] It was observed by Ray, J., "These properties could be made liable to pay tax to the Municipality only if Parliment by law provided to that effect". Whether the statement means that a fresh law should be enacted by the Parliament to render property acquired or constructed after January 26, 1950 liable to taxation is not clear. It is submitted that this is a needless limitation as S.4 of the Railway(Local Authority Taxation)Act, 1941 empowers the Central Government to vary any existing liability under prior notification. But the flaw in the decision of the Supreme Court seems to be the result of not keeping apart the sub clauses(1) and (2) of Art. 285. That is to say under sub clause(1) if Parliament provides so, the property of the Union becomes subject to taxation by local authority. The existence of the property has relevance only under sub clause(2) of Art.285 as there the power to tax

34. A.I.R.(1973) S.C.1185,1187.

depends on prior taxation of any property belonging to the Union Government. There it is clear that if there was no property before the commencement of the Constitution there was no prior taxation by the local authority also. Hence the reliance placed by the Supreme Court on Corporation of Calcutta v. Governors of St. Thomas School,[35] is, it is submitted, totally misconceived.

Article 289,(1) exempts the property and income of a state from Union taxation. Under sub clause(2) Parliament is authorised to tax any trade or business or any operation connected with such trade or business carried on by or on behalf of a government of a state, or any property used or occupied for the purpose of such trade or business or any income arising therefrom. This sub clause is in accordance with the latest trend of law prevailing in other federations.[36] The effect of such a tax on the income of a state from trade or business would be that such state will have "so much less money with which to carry out the functions of government".[37] In U.S.A., Such taxation by the Federal Government was upheld by the U.S. Supreme Court in South Carolina v. United States,[38] not only because of the possible adverse effects to the federal revenue but also on the ground that "There are some insisting that the state shall

35. A.I.R.(1949) F.C.121.
36. In U.S.A. see New York v. United States,(1946) 326 U.S.572 (sale of mineral water by state); South Carolina v. United States,(1906) 199 U.S.437(sale of soft drinks). In Australia see Victoria v. Commonwealth(1971) 45 A.L.J.R.251(a general tax on employers was held to apply to state conducting industry as employer).
37. Menizies J., in Victoria v. Commonwealth,(1971) 45 A.L.J.R. 251,264.
38. (1905) 199 U.S.437, 454-455.

become the owner of all property and the manager of all business. Of course, this is an extreme view, but its advocates are earnestly contending that thereby the best interests of all citizens will be subserved. If this change should be made in any State, how much would that State contribute to the revenue of the Nation". So the original idea to permit such taxation on state enterprise was to discourage state enterprise in business for if the states wished to compete with private sector in the nation's market places they must be willing to pay the price for such competition-subjection to federal taxation.[39]

It is to be conceded that in modern times when the very concept of modern welfare state postulates states entering various fields of trade, business and other services, to subject states to taxation seems not proper and that too when the states have to discharge various social services and find it difficult to discharge them owing to paucity of funds.[40]

Sub clause(3) of Art.289 empowers Parliament to declare any such trade or business[41] to ~~th~~ be incidental to the ordinary functions of a state government and to exempt them from taxation.The difficulty in interpreting the sub clauses(2)&(3)

39.See S.F.Tucker and R.A.Rombro,"State Immunity from Federal Taxation The Need for Re-examination"(1975) 43 George Washington L.Rev.501,547. In U.S.A., such income is taxable even if used for governmental purposes. Allen v.Regents of University,(1938) 304 U.S.439,451.

40.It has been said that"affluence lies with the national government, while the effluents are the responsibility of the states".Michael D.Reagan,The New Federalism (New York, 1972), pp.33-34.

41.Under S.155 of the Government of India Act,1935 such income was taxable only if trade or business was conducted by a province outside its territorial limits.

of Art.289 may be pointed out. If we interpret subclause of Art.289 to mean that ordinarily any trade or business conducted by the states is exempt from Union taxation, and a specific law by Parliament is necessary to tax any trade or business conducted by or on behalf of a state, it follows from that sub clause itself that Parliament may choose to tax some or leave alone other categories. If such a view is taken what is not specifically taxed is exempted and sub clause(3) becomes redundant. Hence the real intention of the framers in enacting the sub clause seems to empower Parliament to make an exemption from a class or category of trade or business liable to taxation.

In the Constitutent Assembly two amendments were proposed to sub clause(2) firstly, to confine the Union taxation to trade or business carried outside the state so as to make it similar to S.155 of the Government of India Act,1935 and secondly, to make such taxation apply to trade or business started after the commencement of the Constitution.[43] The first of these amendments would have made the sub clause really innocuous as a state normally does not embark on business activities outside its territorial limits. However, both these amendments were not pressed in view of an assurance given by Dr.John Mathai,[44] the then Finance Minister, that all public utility undertakings would be outside the scope of union taxation and that if the sub clause is brought into operation in respect of any

42. By Shri P.T.Chacko. See C.A.Debates IX,P.1161.
43. By Shri P.Nataraja Pillai, See C.A.Debates IX, P.1162.
44. See C.A.Debates,IX,pp.1169-1170.

industrial undertaking owned by a state[45] and if there happens to be at the same time, an undertaking owned by the Central Government of the same character" it is our intention that the liabilities imposed upon the state should be equally imposed upon the Centre".

Since immunity from Union taxation is given only to property and income of a state the question has arisen whether such immunity would be available to a statutory corporation set up by state legislatures. In Andhra Pradesh State Road Transport Corporation v. I.T.Officer,[46] the contention was that the ~~contention~~ appellant was conducting the road transport business on behalf of the State of Andhra Pradesh and that its income was really that of the State[47].Gajendragadkar, C.J., speaking for the Court held that Art.289(1) included trading functions also as sub clause(2) which was in the nature of an exception referred to such activities. Clause(2) of Art.289 was held to cover cases of direct trade or trade on behalf of a state by an agent appointed in that behalf. Hence the question

45. In U.S.A., the courts have not yet sustained a state tax found to be levied directly on a nationally conducted enterprise.See T.R.Powell,"The Waning Of Tax Immunities" (1945) 58 Har.L.Rev.633,646.
46. A.I.R.(1964) S.C.1486.
47. Ibid at 1491.

before the Court was whether the income of the appellant from road transport business could be said to be that of the State of Andhra Pradesh. The appellant Corporation, it was found by the Court,[48] could spend its funds for the purpose for which it was created and with the approvalof the State Government for other purposes. Any residue in the profits had to be handed over to the State for road development.[49] It was held that the handing over of the income was notmaterial as it was for a specific purpose.From the decision it appears that if the residue of the income had to be handed over to the State without any reservation as to the purpose for which it had to be utilised, the Court would have viewed the matter differently. In the present set up of modern welfare state where state enters all the non traditional governmental fields such as commerce and industry, creation of statutory corporation is considered to be the proper way to implement the above the programme as that is supposed to give the necessary flexibility in decision making in policy matters free from beaurocratic redtapism. It is submitted, that the highly legislatic view of the Supreme Court would hamper the growth of statutory corporations as states would be enjoying the protection of

48.Ibid at p.1493.This view is understandable as a distinction has to be necessarily drawn between the state as a juristic entry in itself and the individuals and the instrumentalities not identical with the state, but through whom it acts. Se Colin Howard,"Some Problems of Commonwealth Immunity And Exclusive Legislative Powers" (1972) 5 Fed.L. Rev.31,58.

49.Ibid at 1494.

immunity if they run the industry or trade as a departmental undertaking. In such cases the Parliament will have to pass specific legislation if it wants to tax such activities.

The meaning of the term" property" in Art.289 was the subject matter of an advisory opinion of the Supreme Court in In re Sea Customs Act,1878[50] the facts of which were as follows. Under Section 20(2) of Sea Customs Act,1878 customs duty was payable by a state only if imported goods were used in trade or business and under Section 3(1-A) of Central excise and Salt Act,1944 excise duty was payable on goods other than salt produced or manufactured by a state or on its behalf only if such goods were used for trade or business.The Central Government decided to apply the customs duty and excise duty to all state owned goods irrespective of the fact whether they were used in trade or business.The bills by which the aforesaid statutes were sought to be amended were referred to the Supreme Court for an opinion under Art.143 of the Constitution of India. Whether such amendments would be hit by Art.289 was the issue before the Court.The contention before the Court was that Art. 289 only prohibited the Union Government from imposing a "property tax" and an"income tax" on state property. The distinction attempted was between a tax on property and a tax in relation to property, the constitutional protection being

50.A.I.R.(1963) S.C.1760

limited to the former only. The majority[51] of the Court after examining the constitutional provisions observed[52] that if Art.289 (i) completely exempted all property of states from all taxes the power of Parliament to regulate foreign trade by the use of its power of taxation would be seriously impaired and that ~~thax~~ this consideration would have to be kept in mind while interpretting Art.289(1). Another consideration which weighed much with the majority judges was the constitutional provisions which provided for allocation of revenue between the centre and the states and the provisions for grants-in-aid to supplement the deficit in the revenues of states. Sinha, C.J., speaking for the majority observed[53] that it could not, therefore be justly ~~[illegible]~~ contended that the construction of Art.289 suggested on behalf of the Union would have the effect of seriously and adversely affecting the revenues of states. It was also pointed[54] out that if it was held that the states were exempt from all taxation it would be so serious and so crippling to the resources, which the Constitution intended the Union to have, as to make it impossible to give that intention

51. 9 judges constituted the bench which rendered the opinion. The majority judgement was delivered by Sinha, C.J., for himself and on behalf of Gajendragadkar, Wanchoo and Shah, JJ., Ayyangar, J., in a separate opinion concurred with the majority opinion. The minority judgement was delivered by S.K.Das, J., for himself and for Sarkar and Das Gupta, JJ., Hidayatullah, J., ~~for himself and for Sarkar and Das Gupta~~, in a separate opinion concurred with the dissenting opinion.
52. A.I.R.(1963) S.C.1760,1771.
53. Ibid at 1772.
54. Ibid at 1773.

to the words of cl.(1) Art.289.[55] The real flaw in the argument put forward on behalf of the Union Government was that if Art. 289(1) exempted only tax on property, such a constitutional provision was unnecessary and a "case of much ado about nothing"[56] as the Parliament had no power to impose a property tax under the Constitution. The majority met this argument by[57] holding that the Parliament had such power to impose property tax in union territories by virtue of Art.246(4). Rajagopala Ayyangar, J.,[58] who concurred with the majority pointed out that the position under S.155 of the Government of India Act, 1935 was similar as there also the Federal Government had no power to impose a property tax. Here one thing may be mentioned. Under S.155 of the Government of India Act,1935 also the exemption of tax on lands and buildings was restricted only to British India.Thus under S.155 customs duty and excise duty were not prohibited.When the term" lands and buildings" was changed to"property" in Art.289 the constitution makers intended to include moveable property as well within the prohibition of federal taxation and that too irrespective of its situation.[59] Under the existing law no property tax is imposed on movable property.Thus it would seem that the change of the term had no effect on the meaning of the provisions

55.If the exemption was only from a tax on property, any specific reference to trading and business activities in sub clauses(2) and (3) of Art.289 was unnecessary.See S.K. Das, J.(dissenting) in A.I.R.(1963) S.C.1760,1783.

56.See S.K.Das.J.(dissenting) at 1784.

57.A.I.R.(1963) S.C.1760,1773,for the instance of a tax on State property in union territory see Andhra Pradesh v. New Delhi Municipality,A.I.R.(1975) Del.223.

58.Ibid at 1808. (59) See Hidayatullah,J.,(dissenting) at 1803.

Sinha, C.J., speaking for the majority observed that[60] the word" all " did not govern the word" Union taxation" in Art.289(1) as in Art.285 and that under Art.289(2) the property used or occupied in trade or business was made taxable by the Union Government. It was also held that the law available in other jurisdictions[61] also was that the Federal government was able to impose duty on goods imported by states. Thus Art.289(1) was held not to prohibit any indirect tax on property such as customs duty and excise duty S.K.Das.,J., on behalf of the minority pointed out that if Art.289(1) had only a restricted meaning, then the distinction made between ordinary trading actiwities and trading activities which are governmental activities which were governmental activities were unnecessary as taxes on such activities were never understood as property taxes. The majority view in limiting the immunity from federal taxation may be justifiable in view of the supremacy of the national government and that the states and their people are represented in the two houses of its legislature.

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60. Ibid at 1773. In A.G.British Columbia v.Kingcome Navigation Co.Ltd.,(1934) A.C.45,59 Lord Thankerton observed" customs and excise duties are, in their essence, trading taxes and may be said to be more concerned with the commodity in respect of which the taxation is imposed than with the particular person from whom the tax is exacted.".

61. See for U.S.A.,University of Ilinois v. United States, (1933) 289 U.S.48.51; for Canada, A.G. for British Columbia v. A.G. for Canada,(1924) A.C.222(P.C.); for Australia, A.G. for New South Wales v. Collector of Customs,(1906) 5 C.L.R. 818.

Two other articles which refer to immunity of taxation are Art.287 and 288. Art.287 exempts electricity consumed by the Union Government or a railway company from tax on sale or consumption by the states. The Parliament is empowered to enact a law authorising the states to impose such taxes but in such a case the law should provide that the price of electricity sold to the Government of India should be less by the amount of tax than the price charged from other consumers of substantial quantity of electricity. Art.289 exempts from tax any water or electricity stored, generated or consumed or distributed by any authority established by a law made by Parliament for eregulating or developing any inter-state river or river valley by virtue of any pre-constitutional law. If such taxation is attempted by any post constitutioeal law such law would be valid only if it receives the assent of the President of India.

Now the only question which remains for consideration is whether the general principles of the doctrine of immunity of instrumentalities are applicenle in India apart from the aforementioned provisions in the Constitution. In Australia the existence of any such principle was denied by the majority of the Australian High Court in Amalgamated Society of Engineers v.The Adelaide Steamship Co.Ltd.[62],holding that "the doctrine of

62.(1920)28 C.L.R.129,155(Issacs,J.) is not a tax case.The issue was whether the Commonwealth Parliament had power to legislate for the settlement of industrial disputes where the employer of the industry was a state.The majority answered the issue in the affirmative.In Victoria v.Commonwealth (1971) 45 A.L.J.R.251,The Pay Roll Tax Act,1941 which taxed all industrial employers was held to apply to states which were engaged in industry.

'implied prohibition' finds no place where the ordinary principles of construction are applied so as to discover in the actual terms of the instrument their expressed or necessarily implied meaning". But at the same time in Australia there exists a view to confer such immunity to strictly governmental functions which are essential and inalienable.[63] In Victoria v. Commonwealth,[64] Gibbs, J., observed" a general law of the Commonwealth which would prevent a State from continuing to exist and function as such would in my opinion be invalid". But to decide what are the essential functions, capacities or activities of a state is difficult and it has been observed[65] that" only the firm establishment of some political doctrine as an obligatory dogma could bring about certainty in such a sphere". The administration of justice, the preservation of order and the prevention of crime are the most important among such essential functions.[66] It is submitted that there can be

63. See Higgins, J., in Merchant Service Guild of Australia v. Commonwealth Steamship Owner's Assn., (1920) 28 C.L.R.436, 453-454.
64. (1971) 45 A.L.J.R.251, 277-278.
65. Latham, C.J., in South Australia v. Commonwealth, (1942) 65 C.L.R.373, 423. See Stone, C.J., in New York v. United States, (1946) 326 U.S.572, 586 "we regard as untenable the distinction between 'governmental' and ' proprietary' interests". Frankfurter, J., in the same case held the distinction" too shifting a basis for determining a constitutional power" Ibid at 580; Black, J., in Helvering v. Gerhardt, (1938) 304 U.S.405, 426 held that such concepts vary with individual philosophies.
66. Lord Blackburn in Coomber v. Justices of Berks, (18883) 9 A.C.61, 67. See Lord Watson at p.74 also.

consensus in certain areas of governmental activities. One such area is the power of taxation and it has been held[67] to be an essential function of a state. According to Hamilton[68] a law for abrogating or preventing the collection of a tax laid by the authority of the State (unless upon imports and exports), would not be the supreme law of the land, but a usurpation of power not granted by the Constitution".

In the Australian case of South Australia v. Common Wealth[69] the income Tax Act, 1942 imposed a high rate of tax on income so as to make it practically impossible for any state to tax the income further. At the same time the State Grants (Income Tax Reimbursement) Act provided for reimbursement by grants for the revenue lost to the states. It was argued that this was illegal as the Federal Government was trying to achieve indirectly what it could not do directly, that is prohibiting the states from exercising their taxing powers. Latham, C.J.,[70] speaking for the Court observed that revenue was essential for the existence of any organised state and that power of taxation might fairly be said to be an essential function of a state. The Court upheld the validity of the enactments as there was no

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67. Latham, C.J., South Australia v. Commonwealth, (1942) 65 C.L.R. 373, 422 "The power of taxation may fairly be said to be an essential function of a state". His lordship Latham, C.J., also observed that Parliament could not pass a law to prohibit state Legislatures from legislating in general or from legislating upon some particular subject matter. See Ibid at 423.
68. The Federalist No.33 (The Modern Library, New York) p.202.
69 (1942) 65 C.L.R.373.
70. Ibid at 423.

direct prohibition on states from exercising their taxing powers. The decision thus accepted the principle that apart from S.114 of the Australian Constitution there were areas where the doctrine of implied immunity could be applied. In <u>City of Melbourne v. The Commonwealth,</u>[71] the Australian High Court considered the validity of a provision in Banking Act, 1945 which provided that except with the consent of the treasurer of Commonwealth, no bank should conduct any banking business for a state or any of its authorities. His Lordship Justice Owen Dixon observed[72] that the direct operation of the law was to prescribe a course which the executive government of a state must take or to limit the courses available to it. On the important question, whether a law can be held to be invalid for its object or motive notwithstanding that such law is within the competence of a legislature, Dixon, J., observed[73] "But it is one thing to say that a federal law may be valid notwithstanding a purpose of achieving some result which lies directly within the undefined area of power reserved to the States. It is altogether another thing to apply the same doctrine to a use of federal power for a purpose of restricting or burdening the State in exercise of its constitutional powers".[74] It was held that

71. (1947) 74 C.L.R.31. It was held that the circumstance that the primary prohibition was upon banks and not upon states, did not matter, Ibid at 83.
72. (1947) 74 C.L.R.31,79.
73. Ibid at 80.
74. Latham C.J., Rich, Starke and Williams, JJ., wrote separate opinions in which they agreed with Dixon, J. Rich and Starke, JJ., also agreed that a federal law of general application might not validly apply to states and their essential agencies.

the law directly operated to deny to the states banking facilities open to others, and so to discriminate against the states or to impose a disability upon them and the law was held to be invalid.

The only decision in which these principles were not followed was New South Wales v. Commonwealth,[75] in which the facts were as follows. S.105A of the Australian Constitution provided for a financial agreement under which the Commonwealth agreed to take over the outstanding public debts of states and the states on their part agreed to make certain payments to the Commonwealth. S.105 A(5) empowered the Commonwealth Parliament to make laws for carrying out by the parties the provisions of the agreement and such laws were binding on the parties notwithstanding anything to the contrary contained as in the Constitution. The Financial Agreements Enforcement Act,1932 authorised the Attorney General to apply to the High Court for a declaration that the whole or part of the amount due and payable by any state was unpaid and such declaration could be executed even by the attachment of the revenues of that state.[76] The Court by a majority[77] upheld the validity of the statute as a valid exercise

75.(1931) 46 C.L.R.155.
76.In a later decision new South Wales v.Commonwealth,(1932) 46 C.L.R.246 the Court upheld the power of Commonwealth under the Financial Agreement Enforcement Act,1932 to attach bank credits of the defaulting state.
77.Two judges Gavan Duffy,C.J.,and Evatt,J.,dissented.

of power under S.105A. It is submitted that the power to seize and appropriate the funds of a state is too wide a power even if the obligation of the state was unconditional. One of the learned judges[78] of the majority assures us that the decision no application outside the Financial Agreement.

From the above discussion two principles of law follow and may be stated thus. Firstly, in a federation neither the federal nor the component state governments may impose discriminatory taxes on the other. Secondly, in a federation neither the federal nor the component state governments may exercise the taxing power so as to fetter, control, burden or interfere with the essential governmental functions of the other. The Indian Constitution being federal in nature, these principles apply here also. In West Bengal v. Union of India,[79] the issue was whether the Union Government could acquire certain coal-bearing areas owned by the State of West Bengal under the Coal Bearing Areas (Acquisition & Development) Act, 1957. It was argued before the Supreme Court that the power of the Parliament did not extend to enact legislation to deprive the State of property vested in it as sovereign authority. Instead of answering the

78. Owen Dixon, Jesting Pilate, (1965) p.119.

79. A.I.R. (1963) S.C.1241.

problem, Sinha,C.J. for the majority of the Court that the[80] Indian Constitution was not truly federal in character and as such the doctrine of implied immunity was inapplicable in India. It is submitted that the problem was not that simple as a law providing for acquisition of state property can be more effectively utilised to paralise a state government than by way of power of taxation. According to Chief Justice Sinha[82] if the Union Government did so, it would be abusing its power of acquisition. But the doctrine of abuse of power is applicable only to executive action and if Parliament expressly provides so, such a ground would not be available for striking down the law. Under Arts.2 and 3 of the Indian Constitution Parliament has

80. Ibid at 1252.Subba Rao,J.,dissented holding that the Constitution of India was federal in character.Ibid at 1269.
81. Under the Indian Constitution acquisition of property is a subject in the Concurrent List over which both Parliament and state legislatures have legislative competence. But state legislatures cannot provide for acquisition of Union property as state law providing for acquisition of property should receive the assent of the President of India under Art.31(3).This unusual provision found in S.299(3) of the Govenment of India Act,1935 to protect zamindars and other intermediaries in land was retained by framers of Constitution of India intending to exclude zamindari abolition laws from the purview of Art.31. See H.C.L.Merillat,Land and The Constitution in India,(1970) p.129.
82. A.I.R.(1963) S.C.1241. However no such problem arose here and the majority decision is correct.

power to abolish or create new states and hence it has been argued[83] that "Parliament which is competent to destroy a State cannot be held, on the theory of absolute sovereignty of States, to be incompetent to acquire by legislation the property owned by the States". The answer to the above argument is that the Constitution of India envisages an India -- a union of states- and so necessarily guarantees for the continued existence of the Centre and the state governments. In the words of Justice Owen Dixon[84] of the Australian High Court "The objection to the use of federal power to single out States and place upon them special burdens or disabilities does not spring from the nature of the power of taxation. The character of the power lends point to the objection but it does not give rise to it. The federal system itself is the foundation of the restraint upon the use of the power to control the States. The same constitutional objection applies to other powers, if under them the States are made the objects of special burdens of disabilities".

83. M.C.Setalvad, Union And State Relations under The Indian Constitution(Calcutta,1974) P.10.

84. <u>City of Melbourne</u> v. <u>Commonwealth</u>,(1947) 74 C.L.R.31,81.

PART SIX

UNION - STATE FINANCIAL RELATIONS.

CHAPTER XVII

TAX SHARING - GENERAL PRINCIPLES AND THE FINANCE COMMISSIONS

Introductory

In a federation, financial resources have an important bearing on the relative capacity of the central as wellas the several state governments to carry out the responsibilities and functions assigned to them under the Constitution.[1] It is necessary for the two co-ordinate governments to have each "under its own independent control financial resources sufficient to perform its exclusive functions".[2] In an ideal federation the financial resources and functions should be divided fairly between the two governments, as government revenues are the counterpart of government expenditure, the latter primarily depending upon the character and the extent of governmental functions.[3] Apart from this, in a federation there may be wealthy and bigger states and poor and small units.[4] These inequalities

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1. For general comparative study see B.P.Adarkar,The Principles And Problems of Federal Finance(1933) A.H.Birch,Federalism, Finance and Social Legislation(Oxford,1957).
2. See K.C.Wheare, Federal Government (Fourth edition,1963),8 p.93.
3. See Seligman,Essays In Taxation op.cit., p.660.
4. There may be instances of large units being poor and small units being rich.

in financial status constitute the problem of federal finance.[5]

In all modern federations, the state governments are made responsible for the various social services affecting the welfare of the people. In India, states are entrusted with social services such as education, public health, and sanitation. India is largely an agricultural country and agriculture still, to a great extent, depends on rainfall. The low national income and the low standard of living conditions of the majority of the populationcoupled with the increasing rate of the growth of the population make the task of the states more difficult.[6] Further, industry is mainly a state subject except where Parliament declares it to be expedient in the public interest or for defence.

The function of federal finance is to allocate the revenue between the federal government and the states and also among the various states so as to achieve the greatest

5. See R.J.May,Federalism and Fiscal Adjustment(Oxford,1969), pp.161-162. The simple generalisation that can be made, accoding to the learned author, is that every federation contains relatively poor units and relatively rich units and the poor units generally support a central government with strong fiscal powers or a centralized scheme of revenue allocation, while the rich units favour fiscal decentralization and revenue transfers.

6. See entry 24 of List II, entries 5 & 7 of List I of the Seventh Schedule to the Constitution of India.

satisfaction to all governments.[7] The methods normally adopted to solve these problems of federal finance are three, namely, (1) separation of revenues between the central and state governments, (2) sharing of the same revenue between layers of government and (3) grants from the central to the regional governments.[8]

In India, all these three methods are adopted, while in the federations of Australia and Canada the last two methods are adopted as solutions for the problem. However, the planning of a logical, clear cut and well balanced system of federal finance is difficult and even in cases where such balance has been achieved to start with, it is liable to be upset by changing economic conditions. A constant vigil over this problem is necessary to adapt it to the changing conditions.[9]

7. The Report of the Expert Committee on Financial Provisions of the Constitution,(1947), p.129 observed"The Provinces must have adequate financial resources if these services, on which the improvement of human well-being and the increase of the country's productive capacity so much depend are to be properly planned and executed.

8. See Findlay Shirass, Federal Finance In Peace And War(1944) pp.224-228. According to Seligman the sharing may be by three methods,(1) tax assessed and collected by states with additions for the use of central government,(2) tax assessed and collected by central government with additions for use of state governments and (3) revenue collected by central government and a portion assigned to states. See Seligman, Essays in Taxation", op.cit-pp.663-665.

9. " A certain amount of fiscal-autonomy is required, as we saw, to maintain the balance between Central and local authorities; to make either dependent upon the support of the other implies the danger that this fiscal dependence will soon spread to other fields and the federal system thereby the perverted into a unitary one or dissolved into its parts". Bowie & Friedrich, Studies In Federalism(1954), p.389.

The allocation of tax revenue between the Central and State governments is dealt with in the present chapter. The problem of financial grants to poor states is taken up in the last chapter of this part. These two are fundamentally different as even meticulous and elaborate provisions for allocation of revenue between central and state governments will leave certain states in relative poverty.[10] This financial disparity between rich and poor states may even create anti-federal feelings.[11] A third problem of distribution of tax revenue between the various states[12] is not taken up separately but is also discussed in the present Chapter.

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10. Findlay Shirass observes: " A logical or clearcut solution of financial relations is impossible in a Federal Government which is itself, of course, a compromise. No single panacea in financial relations is possible and no single method for co-ordination is possible". See Federal Finance In Peace And War.op.cit-p.223.

11. In Australia the State of Western Australia did attempt on this score to secede from the federation. See Owen Dixon, Jesting Pilate(1965). p.120.

12. In India, the function is entrusted to a body known as Finance Commission to avoid political bargaining."It was felt that if apportionment were left to Parliament, the bigger states having a large majority of M.Ps. would be able to pursue a selfish policy at the cost of the smaller states".See C.H.Alexandrowicz, Constitutional Developments in India,(1957) pp.197-198. See also Ashok Chanda, Federalism in India (1965) p.193.

Division of Taxing Power Under The Constitution.

The Constitution of India has made a clear-cut division of the taxing powers between the Central and the state governments.[13] There is no concurrent field of taxation and the residuary power of taxation is with Parliament. In fact, the experience of other federations shows such concurrent fields of taxation as unworkable.[14] Apart from legislative entries dealing with taxation, the Union Government also possess immense power to control effectively the fiscal policy of the nation. For example, entry 36 of the Union List deals with currency and foreign exchange, entry 37 deals with foreign loans and entry 38 deals with Reserve Bank of India. These mean the control of the internal and external purchasing power of the rupee, deficit financing and consequently control over inflation of money.

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13. But see Art.277 which provides for continuance of pre constitutional taxes levied by states and local authorities even though under the Constitution the power to levy such tax is with the Parliament. See Amraoti Municipality v. Ramachandra, A.I.R.(1964) S.C.1166.

14. In Australia see South Australia v. Commonwealth,(1942) 65 C.L.R.373(the state were compelled to vacate the field of income tax.).

The Union Government has been empowered to levy twelve kinds of taxes[15] under List I apart from any other tax not mentioned in List II of the Seventh Schedule to the Constitution of India as the residuary power of taxation belongs to the Union Legislature.

The state legislatures have been empowered to levy and

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15. They are taxes on income other than agricultural income (entry 82); duties of customs including export duties (entry 83); duties of excise on tobacco and other goods manufactured or produced in India except-(a) alcoholic liquors for human consumption; (b) opium, Indian hemp and other narcotics, but including medicinal and toilet preparations containing alcohol or any substance includided in sub-paragraph (b) of this entry (entry 84); corporation tax (entry 85); taxes on capital value of assets, exclusive of agricultural land, of individuals and companies, taxes on the capital of companies (entry 86); estate duty in respect of property other than agricultural land (entry 87); duties in respect of succession to property other than agricultural land (entry 88); terminal taxes on goods or passengers, carried by railway, sea or air, taxes on railway fares and freights (entry 89); taxes other than stamp duties on transactions in stock exchanges and future markets (entry 90); rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts (entry 91); taxes on sale or purchase of newspapers and on advertisements published therein (entry 92), and taxes on the sale or purchase of goods other than newspapers, where such sale or purchase ~~af~~ takes place in the course of inter-state trade or commerce (entry 92A).

collect twenty taxes[16] enumerated in List II of the Seventh Schedule to the Constitution of India.

Though on principle the Constitution has to safeguard the financial viability of the centre as well as that of the states, a bare perusal of the Union and State List would make one think that the elastic sources of revenue have been assigned to the centre, the states being left with taxes of narrow

16. They are land revenue, including the assessment and collection of land revenue(entry45); taxes on agricultural income(entry 46); duties in respect of succession to agricultural land(entry 47); estate duty in respect of agricultural aldn(entry 48); taxes on lands and buildings (entry 49); taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development(entry 50); duties of excise on the following goods manufactured or produced in the state and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India;(a) alcoholic liquors for human consumption,(b) opium, Indian hemp and other narcotic drugs and narcotics but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph(b) of this entry (entry 51); taxes on entryof goods into a local area for consumption, use or sale therein(entry 52); taxes on the consumption or sale of electricity(entry 53); taxes on sale or purchase of goods other than newspapers subject to the provisions of entry 92A of List I (entry 54); taxes on advertisements other than advertisements published in newspapers(entry 55); taxes on goods and passengers carried by road or on inland waterways(entry 56); taxes on vehicles subject to the provisions of entry 35 of List III(entry 57); taxes on animals and boats(entry 58); tolls(entry 59); taxes on professions, trades, callings and employments (entry 60); capitation taxes(entry 61); taxes on luxuries including taxes on entertainments, amusements, betting and gambling(entry 62); and rates of stamp duty in respect of documents other than those specified in the provisions of List I (entry 63).

and local base only[17]. It is an accepted principle of federal finance that the power to levy a tax must be allocated on the basis of its economic allegiance[18]. That is to say, where the base of a tax is nation-wide, the best authority to tap such source can only be the federal government and not the regional governments[19]. Though the Constitution gave the more elastic

17. See the table below:

(Rs. in crores)

Taxes	1950-51	1960-61	1967-68	1968-69.
Central Taxation:				
Income tax	149.3	174.4	335.2	389.6
Corporation tax	43.8	110.7	310.5	299.0
Excise duty	67.5	416.4	1082.8	1342.9
State Taxation:				
Agri.Income-tax	3.59	11.92	12.05	
Land revenue	49.60	97.50	104.74	108.98
State excise duty	48.03	53.09	109.60	
Sales-tax	56.00	158.00	509.00	561.20

18. See B.P.Adarkar, The Principles And Problems Of Federal Finance(1963), p.227.
19. See Seligman,Essays In Taxation op.cit., pp.379-380.

sources of revenue to the Centre, recognized the necessity of providing the component states with financial resources to meet their responsibility more fully. This is done by way of devolution of money from central taxes and by way of grants-in aid on the recommendation of an expert body known as the Finance Commission.[20]

Tax Sharing.

The tax sharing system envisaged by the Constitution of India falls into four types. The first type is under Art.268 by which stamp duties and duties of excise on medicinal and toilet preparations metnioned in the Union List of the Seventh Schedule to the Constitution though levied by the Union Government shall be collected by the state governments. Under this provision since the Union Government imposes the levy, the rate shall be uniform throughout India. The second type ~~of~~ is under Art.269 by which succession duty and estate duty in respect of non-agricultural property, terminal taxes on goods or passengers carried by railway, sea or air, taxes on railway fares and freights, taxes, other than stamp duties, on transactions in stock exchanges and future markets and taxes on the sale or purchase of news papers and on advertisements published therein though levied and collected by the Union Government are wholly assigned to the states within which such taxes are leviable.This seemingly impressive list of six taxes whose receipts are to be handed over to the states is of no practical

20.The term"finance commission" was first used in the Report of Royal Commission on Dominion- Provincial Relations. But this recommendation was not implemented in Canada.

value as only two taxes mentioned therein are levied at present. The third type is under Art.270 by which income-tax, excluding corporation tax, levied and collected by the Union Government has to be shared with the various states.The fourth type is under Art.272 by which excise duties levied and collected by the Union Government may be shared with the states.[21] The proceeds attributable to the share of states under the third type do not form part of the consolidated fund of India,while under the fourth type any amount to be given to the states has to be taken out of the consolidated fund of India by appropriation acts.These provision make the Union Government" the banker and collecting agent for the state governments".[22]

History of the Financial Provisions.

Before dealing with the constitutional provisions in detail, we may examine briefly the history of these provisions. Under the Government of India Act,1858,[23] the Secretary of State in Council had absoelute control over the expenditure of revenues of India,which was one and indivisible and negatived any concept of provincial revenue.[24] It is said that the commercial principles

21.The third type of tax sharing may be called obligatory,while the fourth type may be called optional as it is only discretionary with the Parliament.

22.SeeGranville Austin, The Indian Constitution:Cornerstone of Nation(1966) p.221. According to P.B.Mukherji" The Union has naturally the favourable position as a collector and distributor of taxes and as the donar of grants" See Mukharji, P.B. The Critical Problems Of TheIndian Constitution(1968) Bombay), p.132.

23.21 & 22 Vict.c.108. See Ss.XLI and LIII: See Sir John and R.Strachey, Finances And Public Works Of India 1869-1881 (London,1882),p.134.

24.See Report on Indian Constitutional Reforms(Calcutta,1928) p.69. See also B.B.Misra,The Central Administration of The East India Company(1959) Ch.III.

which underlay the company's rule sufficiently explained the original decision that the Central Government should keep full control of all revenues in their hands. The British Parliament also exercised much control over Indian finance through the Secretary of State-n-Council.[25] This position continued till 1870, when Lord Mayo made the first attempt to make provincial governments responsible for the administration of local finances.[26] The underlying idea was to produce greater care and economy and to impart an element of certainty which was absent till then in the financial system. By this arrangement the Central Government was relieved of onerous duties, incessant and vexatious claims by the provinces without the sacrifice of superior control. But regarding the grants made over, the Government of India had simply followed the financial basis as it stood then and gave to each province the amount of appropriation which it received in the previous year. This system continued till 1882.

25. The Secretary of State had to make annual financial statements to the House of Commons. See C.H.Philips, The Evolution of India And Pakistan 1858-1947. Select Documents (Oxford), pp.15-16.
26. See Government of India's Resolution on pProvincial Assignments of 14th December,1870. Parliamentary Papers, Vol.49(1871), No.29 India Office Library,reproduced in C.H.Philips, Evolution Of India And Pakistan,op.cit., pp.580-583. Under this the Government of India made over to the provincial governments certain departments of administration such as jails, registration, police, education, medical service except medical establishments, printing, roads, etc., and an annual permanent grant of £4,688,711 subject to certain conditions was made.

In 1882, under the regime of Lord Lytton, for the first time[27] the principle of allocation of certain proportion of the revenue to each province was adopted instead of giving fixed sum of money as grants. The new arrangement was to retain certain heads as Central, certain others to be divided equally between the Centre and provinces and the rest to be made wholly between provincial. Thus under the Government of India's Financial Resolution of 30th September,1881,[28] the heads of revenue made over to provinces were thought to offer most prospect of development under careful provincial management. They were forests, excise licence tax(the former income-tax), stamp duty, registration, provincial rate, law and justice, public works and education.As the receipts from these heads were not sufficient to meet the provincial needs, a system of tax sharing was first introduced- a percentage of land revenue, a head of revenue retained by Government of India had to be given to the provinces. This new phenomenon of federal finance was considered to have an advantage, namely, that the provincial governments would have a direct interest not only in the provincialised revenue, but also in the most important item of central revenue raised within the province, namely land revenue.

27.See John Strachey, India,Its Administration And Progress (London,1911),pp .121-122.

28.Parliamentary Papers,Vol.51(1883),Paper No.93. India Office Library,reproduced inC.H.Philips, Evolution Of India And Pakistan op.cit., pp.586-588.

The division of revenue on the above-mentioned lines did not solve the problem and was subject of quinquennial revisions in 1887,1892 and 1897 [29]. Thus the scramble and wrangling between the Central and provincial governments for funds revived at periodical intervals of five years. Under the prevailing system of financial settlement, each provincial government was supposed to be free to enjoy the fruits of its economy by successful nursing of its revenue. But as the assignments at each new revision were based on the actual scale of expenditure, each province had to make the scale of expenditure as high as possible by spending money not on carefully matured schemes of well thought out improvement but such as that can be carried through before the close of the settlement, in order to leave as small a balance as possible for resumption at the impending revision. Further the apportionment of revenue to provinces was not made on the basis of any scientific or logical principles but on the basis of actual expenditure and was considered to be not conducive to economy but to be even setting a premium on extravagance.

Thus in 1904 a financial settlement of a quasi permanent nature was attempted by giving to the provincial governments a permanent interest in the revenue and expenditure

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29. The Central Government had the power to modify the scheme under ceitain conditions. Thus in 1882 as the finances were in a better position as an additional 26 lakhs of rupees were given to provinces, but in 1887 the Central Government resumed 64 lakhs and in 1892 resumed a sum of 46 lakhs.

under the control and by establishing a basis for fixing the provincial assignments in accordance with certain broad and simple principles.[30] Thus it was decided that the provinces should be given a slightly small share of growing revenues and at the same time to divide the corresponding head of expenditure in the same proportion.[31] It was also proposed to cover any excess of provincialised expenditure by fixed cash grants. In 1909 the Decentralisation Commission went into the problem in much detail but on the whole advocated the continuance of the existing system.[32]

30. "The growth of the fiscal autonomy of the provinces may be briefly described as a process of evolution, still incomplete, from status to contract and from contract to contribution."See K.Vysa Rao, The Future Government of India,(Macmillian,1918) p.95.

31. See Indian Financial Settlement(1904-5),pp.66-67. Parlimentary papers, No.193, India Office Library. Reproduced in C.H.Philips, Evolution Of India And Pakistan op.cit.,88. pp.592-594.

32. See Report of Decentralisation Commission, Cmd.4360,p.34-44. One of the recommendations - to give more independance to provinces in the preparation of budgets- was accepted by Governor General Hardings in 1912. The settlements were also made"permanent".

Fresh thinking on the lines of federal finance was first made in 1918 in Montague Chelmsford Report. For the first time a separation of the sources of revenue was advocated. It recommended the transfer of judicial stamps, irrigation, excise and land revenue to the provinces, while general stamps and income-tax had to be retained by the Central Government and[33] also provided for fixed contribution by provinces to cover up the deficit in Central revenues. Lord Menston's Committee on Financial Relations again examined the matter under the Government of India Act,1919. The Committee recommended the transfer of general stamp also to the provinces as it thought that the provinces should start the new phase of independent finances with some reasonable working surplus.[34] By this transfer, the provinces had a net increase of revenue of Rs.1850 lakhs. From this amount the provinces were allowed to retain Rs.867 lakhs and the remainder, Rs.983 lakhs, had to be handed over to the Central Government. The Report shows a refreshing concern for the stability of provincial finance and to make them independent so far as possible from Central control as well as assistance even in the face of a Central deficit. This pattern continued to be the set up of distribution of revenue for some time except for the recommendation of Indian Taxation Enquiry Committee (1925) for transfer of revenues from excise on foreign liquor

33. See Report on Indian Constitutional Reforms,(1918) pp.132, 134.The Joint Select Committee of the House of Lords and House of Commons(1918) recommended also 25% of the income tax to be handed over to provinces.See Findlay Shirass, Federal Finance in Peace And War op.cit., pp.187-188.
34. See paras 8 and 11 of the Report(1920) reprodosed in P. Mukherji, The Indian Constitution(1920) Part II, p.547,550. For criticism see B.R.Misra, Indian Federal Finance (1960) 3rd edn) Ch.IV.

and opium to the provinces. Thus the only bone of contention remained to be the sharing of income-tax.[35]

The Government of India Act,1935, envisaged a federal government and provided for a demarcation of revenue between the Central and provincial governments. The revenues from taxation under the Act, were classified into four groups. Under S.137 the first category of taxes, though levied and collected by the Central Government, had to be handed over to the provincial Governments. These were(1) duties on succession to property other than agricultural property,(2) stamp duties on bills of exchange, cheques, promissory notes, bills of lading, letters of credit, insurance policies, proxies and receipts,(3) terminal taxes on goods or passengers carried by railway or air and (4) taxes on railway freights and fares The proviso to S.137 authorised the Central Government to levy surcharge on the above items for federal purpose. The second category of taxes were levied and collected by the Central Government but a portion of the receipts "is or may be" assigned to the provinces.The Government of India Act,1935, provided for assignment to the provinces of a portion of the income-tax excluding corporation tax and tax on federal

35.The Percy Committee examined the basis of distribution of income tax among the various provinces.See Report of the Federal Finance Committee(1932),Cmd.4069.

emoluments.[36] Here also the Central Government was empowered to impose surcharge for federal purposes. The other taxes which were sharable with the provinces, if the federal legislature thought it desirable, were duties on salt, excise duties on tobacco and other goods which the federal legislature had powers to impose,[37] and export duty.[38] The Act also provided for sharing of the export duty on jute.[39] The third category of taxes for wholly federal purposes were duties of customs, corporation tax and taxes on capital value of assets exclusive of agricultural land of individuals and companies.[40] The fourth category of taxes levied and collected by provinces for provincial purposes were land revenue, excise on alcoholic liquors etc., taxes on agricultural income, taxes on lands, buildings, hearths and windows, succession duty on agricultural land, taxes on mineral rights, capitation taxes, taxes on profession, art, trade or calling, taxes on animals and boats, taxes on sale of goods, on advertisements, octroi, tax on luxuries and entertainments, duties on stamp other than those mentioned in the federal list,tax on passengers and goods carried on inland waterways and tolls.[41]

36. See S.138 of Government of India Act,1935.
37. The Federation had power to impose excise duty on all goods produced and manufactured in India except on(a) alcoholic liquor for human consumption;(b) opium, hemp and other narcotics and non-narcotic drugs, and(c) medicinal and toilet preparations. See entry 45,List I of Seventh Schedule to the Act,1935.
38. See S.140 of Government of India Act,1935.
39. See S.140(2) of Government of India Act,1935.
40. See entries 44,45 and 55 of List I of VII Schedule to Act, 1935.
41. See entries 39,40,41,42,43,44,45,46,47,48,49,50,51,52 and 53 of List II of VII Schedule to Act,1935.

Under Section 138, the income-tax receipts that were made shareable between the Central and provincial Governments were exclusive of tax payable in respect of federal emoluments and corporation tax. It is quite interesting to see the exemption in relation to tax on salary of federal employees brought in to the Constitutions as it is difficult to support it on principle except perhaps on practice.[42] The term"Corporation tax" was defined by S.311(2)[43] to mean super-tax on profits of companies.The Govrenment of India Act,1935 had left the ratio of income-tax receipts to be shared with the provinces to be determined by an order-in-Council.[44] Sir Otto Niemeyer was appointed under the terms of the Act to examine the whole question and his recommendations were accepted and embodied in Government of India(Distribution of Revenues) Order,1936.[45] This Order-in-Council as amended in 1940 regulated the sharing of income tax between the centre and the provinces till the Constitution came into force.

42. This practice can be traced to the Report of the Percy Committee (1932),Cmd.4069.
43. The definition was as follows:"Corporation tax means any tax on so much of the income of companies as does not represent agricultural income, being a tax to which the enactments requiring or authorising companies to make deductions in respect of income-tax from payments of interest or dividends or from other payments representing a distribution of profits, have no application".
44. The White Ppaer(1933) had suggested a share between 50% and 75% But the Joint Parliamentary Committee of British Parliament was of opinion that it should not exceed 50% in any case.
45. Under the terms of this Order-in-Council,50% of the receipts was treated as the provincial share.However,the enjoyment by provinces was postponed firstly for a period of 5 years and secondly for a further peiod of 5 years during which itwas provided that there should be a gradual and automatic reduction of the amount withheld by the Federal Government.

A Critical Study Of The Constitutional Provisions.

The above brief outline of the history of federal finances in India clearly reveals the fact that our founding fathers had all the crystallised wisdom of a century before them when the Constitution was enacted. It is true that fresh thinking on this subject was done by the draftsmen of the Government of India Act,1935. Most of these provisions have found their way into the Constitution of India.[46] Thus the imperial thinking of the first thirty years of the present century forms the foundation of a good deal of our central-state fiscal relationship.The variations made in the present Constitution are the following:

(1) Firstly we may examine Art.268 which deals with a new category, namely, taxes levied by Parliament but collected by the respective states. They are:

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46. The Drafting Committee of the Constitution of India had left out the recommendations of the Expert Committee on Financial Relations with regard to the distribution of the revenues between the Centre and the States. The reasons given was as follows: "In view of the unstable conditions which at present prevail in this field the Drafting Committee has thought it best to retain the status quo in the matter of distribution of revenues for a period of five years, at the end of which a Finance Commission may review the situation". See Draft Constitution of India (1948) p.XI cl.(15) and also foot-note at p.115. Reproduced in B.Shiva Rao, The Framing Of India's Constitution(1968) Vol.III,at 516,611. The revision after the lapse of five years remained a pious hope.

a)Stamp duties mentioned in entry 91 of List I of Seventh Schedule to the Constitution. Under S.137 of the Government of India Act,1935, stamp duties mentioned in the Federal Legislative list had to be levied and collected by the federation but had to be assigned to the provinces. Further, under entry 91 of Union List, the new additions are stamp duties on transfer of shares and debentures. The stamp duties on these two items under the Government of India Act,1935, were covered by entry 51 of Provincial List and were levied and collected by the provinces.

b) Duties of excise on medicinal and toilet preparations[47] as are mentioned in the Union List. Under entry 84 of Union List, this includes excise duty on medicinal and toilet preparations containing alcohol, opium, Indian hemp, other narcotic drugs and narcotics. Under the Government of India Act,1935, excide on medicinal and toilet preparations containing alcohol, opium, Indian hemp, narcotic drugs, narcotic and non-norcotics were covered by entry 40 of Provincial Legislative List.

Thus it could be seen that under Art.268 the states have received no additional revenue but that it only provided that certain taxes, which were levied and collected by Central Government but assigned wholly to the provinces under S.137 of

47. Excise duty on medicinal and toilet preparations was a provincial matter under the Government of India Act,1935. It was made subject to Union Legislation at the instance of a private pharmaceutical concern.See Granville Austin, The Indian Constitution,Corner Stone of A Nation, op.cit., p.225.

Government of India Act,1935, and certain other taxes levied and collected exclusively by the provinces were made leviable by the Centre and to be collected by the states.

(2) Secondly, taxes mentioned in Art.269, though levied and collected by the Centre, are assigned to the states. It may be compared with S.137 of the Government of India Act, 1935.

Art.269	Sec.137
1. Duties in respect of succcession to property other than agricultural land.	-do-
2. Estate duty in respect of property otherthan agricultural land.	Stamp duties mentioned in Federal List.
3. Terminal taxes on goods or passengers carried by railway, sea or air.	Terminal taxes on goods or passengers carried by railway or air.
4. Taxes on Railway fares and freights.	-do -
5. Taxes other than stamp duties on transactions in stock exchanges and future markets.	
6. Tax on sale or purchase of newspapers and on advertisements published thereon.	
7. Taxes on sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-state trade or commerce.	

Here therefore, the framers of the Constitution have added estate duty on property other than agricultural land, terminal tax on goods and passengers carried by sea, taxes other than stamp duties on transactions in stock exchange and future markets, tax on sale or purchase of newspapers and advertisements and inter-state sale or purchase tax on goods other than newspapers. In the above list some are new taxes and some were covered by the taxing entries in p Provincial Legislative List of the Government of India Act,1935. For example, entry 48 of the Provincial List which read"taxes on the sale of goods and on advertisement" would certainly cover tax on sale or purchase of newspapers and advertisements and also inter-state sales-tax on goods. It is to be remembered that Government of India Act,1935 contained no prohibition against imposition of tax on inter-state sales or purchase[48] With regard to the other taxes, it could be said that they were really new taxes as neither the Federal Government nor the provincial governments had power to impose those taxes under the Government of India Act,for under S.104 of the Act the residual power of legislation was vested neither in the federal nor provincial legislatures, but the Governor General could,in his discretion, allot such items including a tax to either of them. Since under the Constitution the residuary legislative power vests with Parliament, the framers were really making a distribution of those taxes, which were hitherto not levied in this country, between the states and the Centre.

(3) Thirdly, even under the Government of India Act, 1935, the difficulties had arisen only with regard to the allocation of income-tax,being the chief source of revenue.

48.Even under the present Constitution,the power of the states was taken away only in 1956 by the Constitution(Sixth Amendment) Act,1956.

Article 270 provides that tax on non-agricultural income levied and collected by the Central Government, except the portion which represents proceeds attributable to union territories and tax payable in respect of union emoluments shall be distributed between the Union and the states. Under sub-clause(4) it was specifically provided that tax on income did not include corporation tax. It could be seen that this is exactly a reproduction of S.138 of the Government of India Act,1935,leaving out certain provisions for postponement of the share of provinces for certain years.

(4) Fourthly, under Article 272 excise duty on goods other than medicinal and toilet preparations is made sharable revenue at the discretion of the Parliament. Under S.140 of the Government of India Act,1935,the items of revenue which were sharable at the discretion of the Federal Legislature were(a) duties on salt,(b) duties on ~~exer~~ excise, and(c) export duties. Among these the Constitution has left out duties on salt and ~~ex~~ export duties. Under the Constitution there exists no separate duty on salt other than the duty levied under Central Excise and Salt Act,1944 and no separate provision was felt necessary. Thus the Constitution has left the item of export revenue from this group.

(5) Fifthly, Article 273 provides for grants-in-lieu of export duty on jute to States of Assam, Bihar,Orissa and West Bengal for ten years or till such duty is levied whichever period is earlier. The only change made in Art.273 from S.140(2) of the Government of India Act,1935 was that under the latter

one-half or such greater portion of the net proceeds as determined by His Majesty-in-Council had to be handed over to the provinces in which jute was grown in proportion to the respective quantity of jute grown therein, while under the former the jute growing states had no right to any such share in the actual receipts but had only a right to get an amount in lieu of such share.

The above analysis brings out the fact that the changes made by the framers of the Constitution in the provisions of the Government of India Act,1935 are very little and of not much importance. The adoption of a system envisaged for the thirties had its own inherent defects. It is to be said, that this more or less wholesale adoption of the provisions of the Government of India Act,1935 has at least helped to avoid the conflicting tax jurisdictions in the field of two major sources of revenue, namely, the income-tax and excise duty. In all other important federations the necessity for a uniform law to tap these sources is hard felt. The framers of the Indian Constitution have to be congratulated in entrusting the difficult problems of fixing the share of the states in the central revenue and the distribution of it among the states to an independent agency, namely, the Finance Commission.

But why the framers of the Constitution were carrying into the Constitution the exclusion of tax on corporate income from the divisible pool and the tax on salary of federal employees is diSficult to explain. So also the impressive list of taxes mentioned in Art.269 is also difficult to explain.

Even under the Government of India Act,1935 the system had been found unworkable. Since the Central Government had no share in the collection, such taxes are never levied or collection, such taxes are never levied or collected with enthusiasm.[49] The recommendations of the Fifth Finance Commission may be noted.[50]

1) With regard to succession duty in respect of enon-agricultural property, the recommendation was that estate duty was already being levied and they thought that there would be no particular advantage in levying succession duty also. It is true that estate duty is paid out of the estate of the deceased while succession duty is to be paid by the person who succeeds to the estate. At present the taxable minimum value under Estate Duty Act is Rs.50,000/- would it not be worthwhile to consider a levy of succession duty at a lower minimum level?

2) With regard to terminal taxes on goods or passengers carried by railway, sea or air, the observation was that they were of opinion that a terminal tax levied on goods carried by railway would be administratively inconvenient as it would involve collection of tax at different rates according to

49. At present the only taxes levied are(1) estate duty and(2) tax on inter-state sale and purchase. The tax on railway freights and fares has been abolished in 1961 and only a specific grant is given in lieu of such tax. The grant was Rs.12.5 crores upto 1965-66 and Rs.16.5 crores from 1966-67.

50. See Report of the Finance Commission(1969)pp.68-79.

destinations and separate accounting of receipts to be transferred to each state for different local areas therein. A terminal tax of the above nature is a tax on import or export of goods from a railway station seaport or airport. First of all, it ~~does~~ need not be levied both on import and export. Secondly, it need not be imposed at rates varying with the distance of destination and could very well be a fixed sum. Thirdly, the tax collected may be entrusted to the Finance Commission and need not be handed over to the states directly. So the objections raised by the Fifth Finance Commission to its levy and collection cannot be accepted as correct. With regard to terminal tax on passengers through railway, and that on goods and passengers by ~~sea~~ sea and air the possible revenue estimated was only 8 crores[51] in an year. That is to say that in 1950 when the Constitution was enacted such a tax would not have realised anything worth its name.

3) With regard to tax on railway fares and freights, the tax was imposed in 1957 and continued to be levied till 1961. After 1961 the Central Government gives fixed grants in lieu of such tax.[52] The tax was merged in the fares on a recommend-

51. 5 crores from tax on passengers carried by railway,½ crores from tax on passengers carried by sea and 2½ crores from tax on passengers carried by air.The objection to existing high fare and freights in railway, ships and aeroplanes has not deterred the Union Government from increasing the fares and freights.

52.The Sixth Finance Commission observes" We also feel that the repeal of the passenger tax and its replacement by a fixed grant was not quite in accordance with the spirit, if not the letter, of the provisions of Article 269 of the Constitution" .Report of the Finance Commission (1973),p.24.

ation of the Railway Board that it required the amount for a term of five years. The tax has notbeen reimposed even though fares have been increased considerably during these years. The Finance Commission recommended against the revival of the tax in view of the unsatisfactory state of railway finance. The same view was taken in respect of tax on railway freights[53] also as it was feared that such a tax would increase the price of goods.

4) With regard to tax on transactions in stock exchanges and future markets, the Commission recommended against their imposition as they were estimated to fetch only a small yield.[54] The Commission was, however, in favour of increasing the rate of stamp duties levied now on these transactions.

5) Taxes on the sale or purchase of newspapers and on advertisements published in them were the only taxes recommended by the Commission though with certain hesitation.

This leaves the receipts from tax on personal other than corporate income and duties of excise which is optional with the Parliament, as the major sources of divisible revenue.

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53. The tax on railway freights was never imposed after the Constitution.It was imposed only once,as early as during the first world war but was discontinued in 1922.
54. Rs.1 crore from tax on transactions in stock exchanges and 16 lakhs from tax on future markets.

The Finance Commission And Tax Sharing.

The Constitution of India under Article 280 provides for the appointment of finance commission periodically at intervals of five years to decide the distribution between the Union and the states of the net proceeds of taxes which are to be, or may be, devided between them and the allocation between the states their respective shares.[55] The recommendations of the successive finance commissions on the distribution of income tax and excise duty are taken up first here. The First Finance Commission under the Chairmanship of K.C.Neogi submitted the recommendations in 1952. The main recommendations were for the increase of the share of states in income tax receipts[56] by 5% (50 to 55%) and for the division of revenue from excise duty on three commodities. The report of the Finance Commission is important only is in respect of the bold step of recommending a share of excise duty for the states. Regarding the distribution of the income tax receipts among the various states, the Commission observed[57] that the underlying purpose of the

55. The Parliament has enacted Finance Commission(Miscellaneous provisions) Act, 1951.
56. See Report of the Finance Commission(1952), p.71, 82. The reason shown for this slight increase was more interesting- increase of participants namely after the integration of princely states in Indian Union, they were also entitled to such shares.
57. See Report of The Finance Commission(1952) p.75. The main claim was that of Bombay(the present Maharashtra) and West Bengal wherefrom 75% of the tax was collected and these States wanted a distribution of the state's share of the tax on the basis of collection and the other poor states demanding such distribution on the basis of population, economic backwardness etc. See p.71 of the Report.

devolution was to provide larger funds available to meet the expanding responsibilities in respect of welfare of their population. Though the Commission earlier rejected the concept of compensation or reimbursement to states, the Commission finally decided to distribute the share on the basis of population so far as 80% was concerned and the rest on the basis of collection.[58] The Commission also recommended 40% of excise revenue on tobacco, safety matches and vegetable produce as the share for distribution among the states. The Commission observed[59] " we have fixed the State's share with reference to the amount which, in our scheme as a whole, we consider it appropriate should be transferred to the States by the division of excise duties".

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58. The shares of different states ranged widely as a result of this formula, for example from Bombay(17.5%) Uttar Pradesh(15.75%) Madras (15.25%) West Bengal(11.25%) to Travancore-Cochin(2.5%) Saurashtra(1%) and Patiala and East Punjab.(.75%). The share set apart for Part C.states (the present Union Territories), 2.75% was greater than the total share of Saurashtra and East Punjab Union.

59. See Report,(1952) p.82. In 1952-53 excise duty was levied only on thirteen commodities.

The statement is particularly interesting for the total absence of any data or other reasons. The share of the states was distributed among the various states on a per capita basis.[60]

After the First Finance Commission's report the changes which took place in the country were the reorganisation of states in 1956 abolishing the Part A and Part B States, imposition of estate duty in 1953 and imposition of a tax on railway fares in 1957 under Art.269. The Second Finance Commission was appointed in 1956 under the Chairmanship of K.Santhanam and its report was submitted in 1957. The Commission increased the share of states in incometax revenue to 60% from 55%.[61] In respect of the principles which should govern the distribution of this amount among the states the Commission was in favour of a division on the basis of population alone, but recommended the distribution of 90% on the basis of population and the rest on the basis of collection. In respect of excise duty, the Commission added five more commodities[62] to the list of tax shareable commodities of the First Finance Commission. But the

60. Ibid p.82. Presumably the volume of the population might give a rough idea of consumption. One of the members of the Commission, Mr.Justice Kaushalendra Rao in a minute appended to the Report recommended the distribution of these revenue strictly on the basis of population. See Report,(1952),pp.112-123.
61. See Report Of The Finance Commission,(1957) p.39. It was observed that income-tax had ceased to be an expanding source of revenue it was before. The share of union territories was fixed at 1% .
62. They were sugar,tea,coffee, paper and vegetable non essential oils.See Report,(1957),p.43.

share of the states in excise duties was reduced to 25% from 40%.[63] As to the principles of distribution of this amount among various states, the Commission recommended 90% to be distributed on the basis of population alone and the rest to be used for any other adjustment in favour of any state was in need of financial help. The report of the Second Finance Commission is important in respect of one factor, namely, the realisation that in India, population can be the only and almost sure method of distribution of these revenues among the states in the absence of other relevant data.

The Third Finance Commission under the chairmanship of Ashoka Chanda submitted its reports in 1961. The important charges that occured during the period prior to the Third Commission were the exclusion of income-tax paid by companies

63. The Commission observed that receipts from excise had increased from 83 crores in 1952-53 to 259.5 crores in 1957-58. But this amount was the total revenue from excise on 29 commodities.The Commission had omitted to give any figure as to the amount of duty on these eight commodities selected for tax sharing. In the absence of such data any enquiry as to the propriety of the reduction of state's share is difficult. See Report of the Finance Commission, (1957)pp.42-43. Additional duties on excise had been levied on certain goods in lieu of sales tax. The Commission was of the view that in such cases the states should be given the guaranteed amounts for the loss of their revenue from sales tax and the rest, if any, had to be distributed on the basis of percentage of increase of salestax collection and population.

from the shareable proceeds by the classification of such tax as corporation tax in 1959 and the merger of tax on railway fares in the railway fares in 1961.[64] Though there was strong demand on the part of the states for transfer of the whole of the income-tax to the share of the states,[65] the Commission thought that the Central Government which levied and collected the tax should have a continuing interest in the tax receipts and assigned to the states a share of 66 2/3%(i.e.2/3 of the proceeds.) Regarding the principles of distribution among the states, the Commission observed that since tax paid by companies had been excluded the bulk of the remaining receipts represented the income of local origin. This factor had induced the Commission to give a larger weightage in favour of collection and the recommendation was to distribute 80% on the basis of population and the rest on the basis of collection.[66]

In respect of excise duty receipts, the Commission[67] observed that a more extensive use of Art.272 was not only justified ~~th~~ but also necessary and included all commodities in

64.On this behalf a grant of Rs.12.50 crores was given in lieu of receipts of such tax.

65.Here also the Commission has not cared to give any date as to the extent of the dwindling of the shareable taxes by the exclusion of the tax on corporate income.The share of the Union terrirories was increased to 2.5% .So when a 6% increase in the share of the states is made by the Commission, 1.5% increase is made for the union territories.

66.See Report Of The Finance Commission.(1961),p.18.

67.See Report Of The Finance Commiss̶ion (1961),pp.20-21.

the list of shareable tax proceeds except those whose yield was below Rs.50 lakhs a year. The share of the states was fixed at 20% and distributed on the basis of population.[68] The share of the states from excise on motor spirit was set apart for a special purpose grant for maintenance and improvement of communications.[69]

The Fourth Finance Commission under the chairmanship of P.V.Rajmannar submitted the recommendations in 1965. As to income-tax, the only change was that the share of the states was increased to 75%. In respect of excise duty, the Commission discarded the earlier formula of making a list of select commodities and made the whole collections from excise duty[70] levied on goods at that time and to be levied within the next five years sharable with the states and fixed the share of the States as 20%. This was recommended to be distributed on the basis of population with reference to relative economic and social backwardness.

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68. The Commission here stressed the important factor of relative financial weakness as a consideration and hence weightage was given to disparity in the levels of development reached, the percentage of scheduled castes, tribes and backward classes in the population etc. See Report Of The Finance Commission(1961) p.22.

69. In relation to additional excise duty in lieu of sales tax by states the Commission followed the principles laid down by the Second Finance Commission.

70. This included the duty levied under Mineral Oils,(Additional Duties of Ex Excise and Customs)Act,1958 also.

The Fifth Finance Commission under the chairmanship of Mahavir Tyagi in its report in 1969 also maintained the state's share as 75% of the income tax.[71] However the mode of distribution was changed and 90% was distributed on the basis of population and 10% on the basis of assessment.[72] If the tax sharing system is not based on the principle of compensation to the states of the lost revenue, why any weightage is given to the place of collection by the successive finance commissions is difficult to understand. The Commission retained the state share in excise duty collections as 20% and that was recommended to be distributed on the following basis. That is, 80% to be on the basis of population and of the remaining 20%, 2/3 was to be distributed among the states whose per capita income is below the per capita average income(i.e. economic backwardness) and the 1/3 was to be distributed on the basis of social backwardness.

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71. An increase was not suggested as for the first time the advance tax collections were made available for distribution before the completion of regular assessment. See Report Of The Finance Commission (1969), p.26.

72. By working out the formula seven states account for 70% of the revenue and the remaining ten states get only 30% Of the first category of seven states, Uttar Pradesh gets the highest percentage being 16.01% and Madhya Pradesh gets the lowest being 7.09%. Of the second category of states, Mysore gets the highest percentage of 5.4% and Nagaland gets 0.08% being the lowest.

The Sixth Finance Commission under the chairmanship of K.Brahmananda Reddi submitted the recommendations in 1973. The commission reduced the share due to the union territories to 1.79% of the net proceeds of income tax. But the share of the states in the net proceeds of income tax was raised to 80%.[73] The Commission endorsed the formula adopted by the Fifth Commission to distribute the proceeds among the different states "because there are advantages in our complex federal system in maintaining a reasonable measure of stability in the principles of distribution of sharable taxes."[74] The share of the states in excise duties excluding auxilary duties on certain commodities was fixed[75] at 20% and it was to be distributed among states on the following basis, namely 75% to be distributed on the basis of population and the remaining 25% to be distributed on the basis of economic backwardness,the per capita income being the yardstick.[76]

73. This was done as the unadjusted balances of advance tax collections were not available for distribution among the states. Report Of The Finance Commission,(1973),p.12.
74. See Report Of The Finance Commission,(1973),p.12.90% was distributed on the basis of population and remaining 10% on the basis of assessment. By working out the respective shares of different states, seven states with a population of 67.58% received 67.78% of the tax. They are Addhra Pradesh, Bihar, Madhya Pradesh, Maharashtra, Uttar Pradesh, West Bengal and Tamilnadu. The smallest of six states together got only 2.13% slightly bigger than the share due to the Union terrirotiess(ie.1.79%).
75. The Commission apprehended that an increase of share would result in large surpluses to certain states. See Report. op.cit- p.15.
76. The seven states which accounted for 67.78% of the income-tax got 68.61% of the excise duty also.The basis of distribution makes no appreciable difference in the percentage of the different states.

Thus the Commission categorically rejected the argument that special help to poor states was a criterion only for grants under the Constitution.[77] Regarding the distribution of estate duty and grant-in-lieu of tax on railway passengers, the Commission endorsed the views of the earlier commissions.[78]

Thus it could be seen that the successive commissions have ventured only for slight variations in the area of shareable taxes like income-tax and excise duty.[79] From the table given below it could be seen that substantial amounts have been transferred to the states from centre under the sharing system.

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77. Report Of The Finance Commission, (1973), p.15.

78. Ibid, pp.23-25.

79. The other divisible taxes are estate duty and tax on railway fares. Regarding estate duty the proceeds are divided into revenue from immovable property and revenue from the movable property. The former is allocated according to the value of property in each state and the latter according to population. Regarding the tax on railway fares, the allocation is inaccordance with the passengers earnings by route mileage in each state. The successive finance commissions have reiterated these principles of allocation.

Duration	Total amount of taxes transferred. Crores.	Break up figures of different years.	Crores
I Finance Commission 1952-1953 to 1956-57.	361.61	1952-53 1953-54 1954-55 1955-56 1956-57	73.23 67.18 71.08 71.87 78.25
II Finance Commission 1957-1958 to 1961-62.	851.77	1957-58 1958-59 1959-60 1060-61 1961-62	120.72 162.06 171.88 205.69 191.42
III Finance Commission 1962-1963 to 1968-1969	1066.76	1962-63 1963-64 1964-65 1965-66	236.57 270.96 270.40 288.83
IV Finance Commission 1966-1967 to 1968-1969	1323.67	1966-67 1967-68 1968-69	384.08 431.99 507.12
V.Finance Commission 1969-to 1974.	4605.00		
VI Finance Commission (Estimated) 1974-1979.	7099.24		

Out of the amounts transferred to the states under the tax devolution system, the tax receipts under Art.269 is comparatively small indeed. The substantial bulk comes from income tax and excise duty receipts.

The income-tax has ceased to be a major source for transfer of funds to the states.[80] This is partly due to the exclusion of tax paid by companies by the classification of such tax as corporation tax in 1959. The share of the states in incometax receipts has reached the maximum of 80% and it is unlikely to be raised again in view of the need to ensure a subsisting interest for the Union Government in the levy and collection of the tax. Doubts have been raised as to the elasticity of the source of excise duty so as to do justice in transfering funds to the states. Hence it will be imperative to include corporation tax also in the sharable pool of taxes. The Expert Committee on Financial Provisions of the Draft Constitution[81] had recommended the inclusion of corporation tax

80. During the period of 1951 to 1969 the total amount of transfer of income tax and excise duty to states, are as follows:

Incometax	..	1715 crores
Excise Duty	..	1225 crores

81. See Report reproduced in B.Shiva Rao, The Framing Of India's Constitution.(1968) Vol.III., p.271. As early as in 1923 Seligman had specified corporation tax as one of the three taxes which should be levied by federal government and the proceeds of which should be distributed in whole or in greater part to states. See Seligman, Essays In Taxation op.cit., p.389.

in the divisible pool for tax sharing. This recommendation was not accepted by the drafting committee of the Constitution in India in view of the unstable conditions prevailing at that time and hoped that after the lapse of five years a finance commission could review the matters.[82] This could remain only a pious hope as it was unthinkable that any statutory commission could vary constitutional provisions. Further under the Government of India Act,1935 the term"corporation tax" was defined to mean not the income tax paid by companies but only super tax paid by companies. To classify income tax payable by companies as corporation tax and to exclude such proceeds from the sharable pool was also wrong. Moreover, it is a well accepted principle of public finance that gift tax is imposed to avoid evasion of estate duty tax,[83] and as the proceeds of estate duty are handed over to the states, they are entitled to the gift tax also. Further under the present system, the

82. See Draft Constitution of India, P.XI, cl(15) reproduced in B.Shiva Rao, The Framing Of Indias Constitution op.cit., Vol.III. p.516.

83. "Federal and state taxes upon gift are employed primarily to close an otherwise easily available opening for the avoidance of death taxes" Philip E.Taylor,The Economics Of Public Finance(3rd edn.),P.492. According to willis " tax on gifts is a complement of the estate tax" See Wills Constitutional Law(1936), p.392.

power of taxation enjoyed by the Union Government is unlimited in the sense that it can impose any tax not covered by the State List in the Seventh Schedule to the Constitution even where such tax is expressly excluded in the Union List.[84] Thus the wealth tax on capital value of agricultural assets was upheld in Union of India v. H.S.Dhillon[85],though entry 86 of List I of the Seventh Schedule to the Constitution had expressly excluded agricultural land.[86] Even the framers of the Constitution seemed to be blissfully ignorant of the fact that any new tax had to be made sharable with the states. The absence of a specific provision in the Constitution has left the matter at the mercy of the Central Government.[87] Had

84. See Union of India v.H.S.Dhillon,A.I.R.(1972) S.C.1061,1066. "It seems to us unthinkable that the Constitution makers, while creating a sovereign domocratic republic,withheld certain matters or taxes beyond the legislative competency of the legislature in this country either legislating singly or jointly"(Sikari,C.J.).

85. A.I.R.(1972) S.C.1061.

86. According to T.T.Krishnamachari,"It may be that following the scheme of estate duty on urban and agricultural property even if the Centre has to take over this power under the residuary power after some time, it would assign the proceeds of this levy to the provinces ,because all things that are supposed to be associated with agriculture are assigned to the provinces" See XI C.A.Debates,p.953.

87. See the practice of sharing new taxes with the units in Switzerland K.C.Wheare, Federal Government (1963),pp.97-98. A similar recommendation had been made by the Expert Committee On Financial Provisions Of The Constitution of India(1947),reproduced in B.Shiva Rao, The Framing of Indias Constitution(1967) Vol.III,pp.279-280.

the Supreme Court denied the power to levy the wealth tax on agricultural assets, the states would have been in a bargaining position for a share at least at the time of a constitutional amendment.[88]

Lastly, though Art.274 provides for the recommendation of the President of India for introduction in Parliament of any bill which imposes or varies any tax or duty in which states are interested or for imposition of any surcharge for wholly union purposes, the practice hitherto had been consistant is not consulting the states.[89] Here it is clear that Art.274 refers to the President of India not as the executive head of the Union Government but as the head of the Indian Union. The Fourth Finance Commission also has pointed out the desirability of having a formalised procedure for consulting the states.[90]

Regarding the principles evolved by the finance commissions for the distribution of income tax, excise duty and other taxes, the allocation on the basis of population and collection are the prominent. The successive commissions have been handicapped in this matter owing to lack of reliable data. But the fact that certain states have large surplus after the tax devolution on these principles shows the necessity for changing the present procedure. It is true, that the tax sharing

88. The Union Government has decided to pass over such proceeds from wealth tax to states. But the amount of collection is not worthy of serious consideration, estimate for 1978-79 being only Rs.1 crore. See Finance Commission Report(1973), pp.27-28.
89. For example, in 1961 the tax on railway fares, a tax mentioned in Art.269, was abolished even without any consultation with states.
90. See Report of The Finance Commission(1965) p.61.

scheme has been adopted in the Constitution not with a view to aiding poor states but as a general measure of distribution of revenue between the federal and the state government.[91] But by placing undue importance on population, the most populous states get the greater share. It is suggested that the commission should treat the entire amount of divisible taxes as one[92] and prescribed only one set of principle for distribution of these tax receipts. It is difficult to understand why the finance commissions have not hitherto attempted the distribution on the basis of per capita income.[93] This would have been an incentive to the states to strive for increasing the per capita income also. However, in the final analysis it cannot be gainsaid that "some redistribution of revenue between the States has been consciously embodied in the allocation between states of centrally collected taxes".[94]

91.The broad purpose of the devolution of the revenues to states is "to make larger funds available to them to meet their expanding responsibilities in respect of the welfare of their population". See Report Of The Finance Commission (1952),p.75.

92.See S.M.Veeraraghavachar, Union-State Financial Relations in India(1969) p.99.

93.See K.V.S.Sastri,Federal-State Fiscal Relations in India (1966),pp.102-103 for tables showing distribution on such basis.

94.R.J.May,Federalism and Fiscal Adjustment op.cit.,p.119.

CHAPTER XVIII

THE GREAT GRANTS-OR DOLES

The Problem Of Grants-in-Aid.

The revenue of the Central Government tied to incometax and excise duty has considerably expanded along with the national economic growth. But the state revenues have not shown any such rate of growth during these years. In a federation certain national standards in rendering social services are bound to emerge and the comparatively poor states may find themselves unable to keep up these levels of minimum standards. This problem of poor states who find it difficult to raise revenue to function effectively even after the allocation of sharable tax revenues is attempted to be solved by a system of grants-in-aid[1] under Arts.275 and 282 of the Constitution.

Art.275 reads."Grants from the Union to certain States.

1. Such sums as the Parliament may by law provide shall be charged on the Consolidated Fund of India in each year as grants-in-aid of the revenues of such States as Parliament may determine to be in need of assistance, and different sums may be fixed for different States .

1.The criticism that these provisions are anti-federal in nature may be noticed.here. It is said"Where states are put in a position of being supplicants for favour of money grants from the federation their autonomous position as federal units is jeopardised". See P.B.Mukarji, The Critical Problems of The Indian Constitution(1968),p.133. But there is also another view that where grants are not conditional the units are only exercising their own legislative powers. See G.V.La Forest,The Allocation Of Taxing Power Under The Canadian Constitution(Toronto,1967),pp.40-41.

Provided that there shall be paid out of the Consolidated Fund of India as grants-in-aid of the revenues of a State such capital and recurring sums as may be necessary to enable that State to meet the cost of such schemes of development as may be undertaken by the State with the approvalof the Government of India for the purpose of promoting the welfare of the Scheduled Tribes in that State or raising the level of administration of the Scheduled Areas therein to that of the administration of the rest of the areas of that State:

Provided further that there shall be paid out of the Consolidated Fund of India as grants-in-aid of the revenues of the State of Assam sums, capital and räcurring, equivalent to-

a) the average excess of expenditure over the revenues during the two years immediately preceding the commencement of this Constitution in respect of the administration of the tribal areas specified in Part I of the table appended to paragraph 20 of the Sixth schedule; and

b) the costs of such schedules of development as may be undertaken by that State with the approval of the Government of India for the purpose of raising the level of administration of the said areas to that of the administration of the rest of the areas of that state. . . . .

. . . .

2) Until provision is made by Parliament under clause(1), the powers conferred on Parliament under that clause shall be exercisable by the President by order and any order made by the President under this clause shall have effect

subject to any provision made by Parliament:

Provided that after a Finance Commission has been constituted no order shall be made under this clause by the President except after considering the recommendations of the Finance Commission".

Art.282 reads" Expenditure defrayable by the Union or a State out of its revenues- The Union or a State may make any grants for any public purpose, notwithstanding that the purpose is not one with respect to which the Parliament or the Legislature of the State, as the case may be, may make laws".

It could be seen that under Art.275(1) the grants-in-aid are discretionary except where the case falls under the proviso, namely, grants-in-aid towards the cost of schemes undertaken by state with the approval of the Union Government for promoting the welfare of scheduled tribes and for raising the level of administration of scheduled areas to that generally prevailing in the state concerned. Grants-in-aid are given to states under Art.275 on the recommendation of finance commission[2] The provisions of Art.282, though originally not intended to be extensively used is being used for capital grants to the states by the Union for implementing the respective shares of the five year plans on the recommendation of the Planning

2. The extensive use of Art.282 has been criticised as squandering of the proceeds for such public purposes on matters outside the legal ambit of the Union and the States strikes at the root of the federation and leads to partisanship and misuse of revenue and financial resources to the detriment of true growth of federalism. P.B.Mukharji, The Critical Problems of the Indian Constitution op.cit.p.133.

Commission. These grants recommended by the Planning Commission have been left out of the study both on the ground of symmetry of this work as well as on the ground that the grants given by the commission are mostly in the nature of loans for specific purpose which do not augment the revenues of state.

The provision for grants-in-aid to states is in addition to the system of tax sharing. This is because the states did differ from one another in financial stability and the devolotion of revenue from shareable taxes may not be able to do justice to all states equally and especially so in the case of poor states. The differences among the states are those of "area, climate, topography, natural resources, size and distribution of population and productive capacity, and levels of income and expenditure. In addition, there are considerable differences among states in the average rate of economic growth, as reflected in the growth of population and output of goods and services."[3] The Commonwealth Grants Commission of Australia in its report points out that these differences among the economies of the states give rise to fiscal inequalities in the relative capacity to raise revenue from taxation and ability to provide services to the people. Since a federation is composed of members with widely varying financial capacity for carrying on their equal constitutional

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3. See Commonwealth Grants Commission, Thirty-ninth Report (1972) p.17.

functions, and hence, while a redistribution of certain powers or a re-assignment of taxing fields might solve one of the problems of federal finance, neither could solve the second that caused by the unequal economic strength of different provinces.[4] Such wide disparities in financial resources among the units of a federation have even resulted in claims for secession in Australia.[5]

The Position In U.S.A.And Canada.

The problem of grants-in-aid to poor states is seen to exist in all other federations. In the United States of America, because of apparent affluence, the problem is not so acute as it is either in Canada or Australia. In the U.S.A., however, general grants-in-aid are not given and only conditional grants for specific purposes with varying degrees of federal supervision are given to states. In these grants the tendency is to help the poor states by larger funds than other states.[6] The present system is said to[7] have grown up in a completely haphazard manner, devoid of any coherent, consistent, rational, overall plan or policy.

4. SeeR,M.Dawson, The Government of Canada(1963),p.112.
5. See Owen Dixon, Jesting Pilate(1965), p.,120.
6. See J.A.Maxwell, The Fiscal Impact Of Federalism In The United States(Harward,1946),pp.396-403; See generally, George F.Break, Inter-Governmental Fiscal Relations In The United States(Washington,1967).
7. See H.R.Bruce , American National Government(New York,1959), p.146. See also Paul Dommel, The Politics of Revenue Sharing(1974,Indiana).

In Canada, from the commencement of the Constitution in 1867, federal grants to provinces were a usual feature.[8] Though S.118 of the British North America Act had provided that "such grants should be in full settlement[9] of all future demands on Canada", the history of federal finance in Canada showe that in practice the federal grants to provinces was a general feature and determined as a result of much political wrangles rather than on the basis of definite principles. The Judicial Committee of the Privy Council by interpreting the phrase" property and civil rights in the Province" in S.92 of B.N.A.Act denied the Dominion Government the control over many of the social services and thus these services became the sole concern of the provinces[10]

8.The B.N.A.Act,1867 provided for a per capita grant to all provinces, general annual subsidy to cover the expenses of govennment and legislature and a special annual grant of $ 63,000 to New Brunswick for ten years. In 1874,the Dominion Government agreed to give special grant to the other maritime province, Nova Scotia also. On Canadian federal grants a see generally, Moore and Perry, Financing Canadian Federation,(1953).

9."Ironically enough this provision passed through history as the 'finality clause'". P.Gerin Lajoie, Constitutional Amendment in Canada (1950),p.74.

10.W.P.M.Kennedy,"The Interpretation of the B.N.A.Act"(1944) 8 Camb.L.J.146. In A.G. for Canada v.A.G. for Ontario,(1937) A.C.355. The Employment and Social Insurance Act was struck down. In 1940 the B.N.A.Act was amended to include unemployment insurance in federal legislative jurisidction. Bora Laskin observes:" It has become a turism of Canadian constitutional law that judicial interpretation of B.N.A.Act has given the provinces substantive legislative authority (especially in respect of social services) that far exceeds the financial resources and their money-raising power, ~~while it has left the Dominion with financial resources power~~, while it has left the Dominion with financial resources through an ample taxing power overshadowing its regulatory activity. See Bora Laskin, Canadian Constitutional Law(1969). pp.665-666.

which were not in a financial position to undertakes such responsibilities. In 1907 the Constitution was amended to facielitate payment of certain grants to provinces. Though the Royal Commission on Dominion-Provincial Relations in 1937 recommended the abolition of the unscientific per capita basis for grants and to give grants on the basis of need, this important recommendation was not accepted.[11] In 1957 the Dominion Government agreed to pay adjustment grants to maritime states which were always clamouring for grants. The financial grants in Canada are the result of political bargaining determined not on any rational basis but on logic of compromise[12]. This special feature of Canadian federal finance, namely, ad hoc solutions through political bargaining was necessitated by the uncompromising attitude of one Province, namely, Quebec.

<u>The Working Of The Commonwealth Grants Commission In Australia</u>.

The history of federal grants in Australia and the role of the Commonwealth Grants Commission[13] presents an interesting study. No literature on this institution is generally available in India. At the same time the working of this body

11. See generally Birch,A.H.op.cit., pp.198-204.
12. See Moore and Perry,Financing Canadian Federation,(1953) p. 71. According to Dawson,"The history of the subsidies demonstrates not only that final and unalterable agreements can be and are subject to frequent revision, but that population figures can be invented when the actual ones prove unsuitable; that debt allowances can be made for debts which have never existed and that when a subsidy is increased e in order to equalize the treatment among the provinces further adjustments become immediately necessary in order to overcome the injustices which have been occasioned by the very act of equalization. R.M.Dawson, The Government of Canada(1963),pp.109-110.
13. In 1973 the name of the Commission has been changed to Grants Commission under the Grants Commission Act,1973.

offers very instructive illustration to India. Therefore a brief but accurate account of how the Commonwealth Grants Commission functions is given below.[14] Section 96 of the Australian Constitution provided that"During a period of ten years after the establishment of the Commonwealth,the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.[15]

The financial assistance grants from the Commonwealth to the states[16] are both for specific capital purposes and for revenue purposes.[17] Here we are only concerned with the latter category, as only those grants augment the general revenues of the states and only over those, the states have got absolute control, keeping in view the principale of independent resources of federal finance. In Australia such grants are given to all states by the Commonwealth Government on a per capita basis. Thus the most populous states, New South Wales and Victoria get the largest amounts by way of grants under this scheme. But the

14. The object of the Section was"to strengthen the financial position of the Commonweath in view of possible contingencies, by affording an escape from any excessive rigidity of the financial clauses". See Quick and Garran,The Annotated Constitution of the Australian Commonwealth(1901),p.871
15. It has been held that the Parliament" may in the matter of financial assistance discriminate between States as much as it thinks fit". See Viscount Maugham in W.R.Moran Pty. Ltd. v. Deputy Federal Commr.of Taxation,(1940)A.C.838,857
16. For exampls road construction, hydro-electric schemes social services such as hospital,education, etc.
17. These are of two categories. Firstly, the general grants which are available to the states for expenditure at their discretion and secondly the specific purpose grants given to relieve the adverse effects of natural calamities such as draught and floods.

states which have a lesser population and which are in real need of greater assistance are given grants at a higher per capita rate.[18] The principles for the distribution of these grants are arrived at the Australian Premier's conference for a term of 5 years.[19]

The Commonwealth Grants Commission was established in 1933 to examined the assistance to be given to the states under S.96 of the Australian Constitution. In that year three states, namely, South Australia, Western Australia and Tasmania, made applications under S.96. The chief ground for the claim was the unfavourable effects of the tariff policy of the Commonwealth Government. To start with, the commission considered the compensation for disabilities arising from federation as a possible basis for calculating the assistance to be given though it als considered the requirement of financial need.[20] In its Second Report(1935), the Commission observed that the only ground for assistance was the inability of the states to

18. See the Table below:

Figures in $

States	1966-67	1967-68	1968-69	1969-70	1970-71
NewSouth Wales	66.65	70.83	76.15	83.61	106.32
Victoria	64.24	70.59	75.56	85.87	104.03
Queensland	75.98	82.63	90.11.	100.07	123.42
South Australia	85.46	93.43	102.25	110.29	138.14
Western Australia	122.72	125.05	135.29	145.44	166.56
Tasmania	148.27	152.66	153.02	180.18	207.47

19. For the arrangement arrived at the 1970 conference which will be valid upto 1974-75 see Commonwealth Grants Commission 37th Report(1970), pp.24-27.

20. See Commonwealth Grants Commission First Report(1933), p.83.

carry on without it. However, it was only on its third Report (1936) that the Commission finally rejected the principle of compensation for disabilities arising from formation of federation and categorically held that the fiscal need should be the only criterion for assistance by way of grants.[21] This principle has since been followed without any change by the Commission though the methods of applying the principle have changed from time to time. Before examining the method adopted by the Commonwealth Grants Commission in assessing the fiscal need of claimant states, it may be mentioned that the three initial claimant states continued to be recipients of special grants on the recommendation of the Commission up to the year of 1958-59. Under an agreement arrived at the Premier's conference in 1959, South Australia ceased to be a claimant state for some time but again applied for assistance in 1970 and Queensland applied in 1971. In 1968 and in 1974 as per agreements entered into at the Premier's conference, Western Australia and Tasmania have ceased to be claimants. From 1949 onwards the grants recommended by the Commission are in two parts- a completion grant and an advance grants.[22] Now we may

21.The Commission observed"Special grants are justified when a State through financial-stress from any cause is unable efficiently to discharge its function as a member of the federation and should be determined by the amount of help found necessary to make it possible for that State by ~~sespene~~ reasonable effort to function at a standard a-not appreciably below that of other states". See ~~of the~~ ~~Commission in 1968~~ Third Report(1936), p.75,repeatedly quoted in successive reports of the Commission in 1968 at p.48, in 1969 at p.31,in 1970 at p.34 etc.

22.The completion grant will be in final settlement of the claims and in addition to the advance grant paid to the state two years earlier known as the year of review.The advance grant is based on a forecast of the total financial assistance.For example the 35th Report in 1968 deals with completion grants for the year 1966-67 and advance grant for the year 1968-69.

examine the mode of assessment of the fiscal need of a claimant state by the Commission. From its 4th Report in 1937 to its 27th Report in 1960 the commission had adopted the budgetary standards of all other three non-claimant[23] states as the standard. In its 28th Report in 1961 the Commission reconsidered this matter and adopted a two-state standard for the purpose of measuring the budget result of the claimant states. This two states-standard was based on the simple average of budgetary experience of New South Wales and Victoria.[24]

The procedure for assessment of the fiscal need of the claimant states has been changed from 1972-73 onwards.[25] Under the then existing procedure the assessment of the revenue and expenditure needs of the claimant states was indirect in the sense that though the commission took into consideration the various factors of adjustments like relative soverity of taxation, relative expenditure on social services and the relative impact of financial results of state business undertakings, these adjustments were treated only as favourable or unfavourable.[26] Even though a favourable adjustment increases

23. The then non claimant states were New South Wales, Victoria and Queensland.

24. The Commonwealth Treasury was opposed to this view and had always requested for the adoption of a standard based on all non claimant states. The Commission in its 35th Report (1968) decided to adopt the standard based on all non claimant states but postponed the implementation of the new standard to the year of 1970-71. See 35th Report (1968), p.56. This decision was reiterated next year see 36th Report, (1969) p.37. But in its 38th Report (1971) the Commission finally decided not to change its two state standard See 38th Report (1971), p.47.

25. See Grants Commission Forty-first Report (1974), pp.40-41.

26. An Adjustment is described as favourable where the claimant state is found to have made on above standard effort in raising revenue or to have provided a below standard level of expenditure as compared with average of the standard states. It is described as unfavourable in all opposite cases.

the modified budget deficit of claimant state and an unfavourable adjustment decreases the deficit,[27] the recommended grant was subject to the limitation that it should not exceed, save in exceptional circumstances the claimant stage's modified budget deficit.[28] Under the new proceedure the Commission first modified the published budgetary accounts of the standard the claimant states so as to render them comparable. The assessment of the fiscal need of the claimant states is made under the heads revenue andexpenditure. To assess the revenue needs of a claimant state, the Commission calculates the amounts of revenue which the state would have raised had its rates of tax been of standard severity. Then the per capita revenue in the standard states is multiplied by the population of the claimant state and the product gives the revenue which could have been raised inthe claimant state, if its revenue capacity was as high as that of the

27. This has no penalising effect in reality."It is simply a device for ensuring that the claimant state does not receive finance through the grant for an above-standard level of expenditure which is not matched by an above-standard levelrevenue effort, nor for below- standard revenue effort which is not matched by a below-standard level of expenditure. See Thirtyeighth Report(1971),p.43. Hence the only effect is that in the case of an unfavourable adjustment the recommended grant may be reduced.

28. See Thirtyninth Report,(1972),p.55. The unused favourable adjustments may be carried forward to a subsequent year.

standard states. The difference gives the measure of the revenue needs of the claimant state.[29] To assess the expenditure needs on social services and general administration the Commission seems[30] to rely on the per capita expenditure on similar services in the standard states. These two heads of expenditure are added together. From this amounts by way of grants made by the federal government and the amount of advance grants paid, if any, are subtracted and the figure thus arived at is the amount recommended as grant to the claimant states.

The new procedure adopted by the Commission is more beneficial to the states. For example, the budget positions of Queensland and South Australia for 1972-73 shows deficits of $ 187,000 and $4,038,000 respectively. Under the old procedure the grant would not have normally exceeded this amount. But under the new procedure the grants given are $9,750,000 to Queesland and $8,500,000 to South Australia.

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29. This may be a negative amount if the claimant state has an above standard revenue capacity.

30. See Fortysecond Report(1975),pp.68-69; Foftyfirst Report (1974);p.98.

The Commission has been able to a command the confidence of all parties concerned all these years.[31] One of the reasons for this seems to be that the Commission has acquired a status of permanancy in the Australian federal finance.[32] The members constituting the Commission are simi permanent[33] and since the commission enquiries every year(from 1945 onwards the Commission has came up with a report for every year) as to the financial need of claimant states, it has been came to be treated also as a permanent body.

The Role Of The Finance Commission in India.

Now we may examine the role played by finance e commissions of India in the area of grant-in-aid to states. As stated earlier, the purpose of such grants was to help the poor states, who cannot come to an equal footing with other states in the federation even after the distribution of the

31. See R.J.May, Federalism And Fiscal Adjustment(1974),pp.62-63. The Commission has recommended special grants where the principles were found insufficient to assess the needs of a state. See Twelfth Report(1945), p.85 for an instance of such a grant to South Australia.
32. The Commonwealth Grants Commission Act,1933-57 was repealed and re-enacted by the Grants Commission Act,1973. The new act provides for application by the local governing bodies alsofor financial assistance.
33. For example the chairman, Melville and the members Goodes and Lane constituted the Commission in 1968. In 1971 Goodes retired and in 1974 Melville retired. The present Commission consists of Chairman Elsie-Mitchell, Lane and Mathews.

revenue under the tax sharing system[34]. The First Finance Commission recommended both general unconditional grants and specific conditional grants on the basis of the principles[35] such as (a) budgetary needs modified by making adjustments for abnormal, unusual and nonrecurring items of revenue or expenditure(b) the extent of tax-effort in a state (c) the expenditure of a state and economies effected on it(d) standard of social service provided by a state and (e) any special circumstances of national concern causing special financial burden.[36] These principles are similar to those formulated and applied by the Grants Commission in Australia. The Finance Commission,however, did not give the method by which it finally assessed the grants to states.For exampoe, grants have been given to states for backwardness,[37] for the small size of the state[38] and for the progress[39] achieved by them. Then a specific

34. The underlying purpose of grants-in-aid is that each state should be so equipped as to enjoy a reasonable prospect of maintaining financial equilibrium and in particular that the chronic state of deficit into which some of the states had fallen should be brought to an end. See Report of The Finance Commission(1952), p.91.
35. See Report of the Finance Commission(1952), pp.96-97
36. Under this last head West Bengal, because of the special problems of partition, got a grant of Rs.8 million and Punjab got a grant of Rs.12.5 million per year.
37. Orissa got Rs.7.5 million.
38. Sourashtra got Rs.4 million.
39. Travancore-Cochin got Rs.4.5 million and Mysore got 4 million.

purpose grant was made for primary education to eight states on the basis of proportion of children attending school to total of children of the age group of 6-11 in such states.[40] Thus the First Finance Commission gave grants-in-aid to seven states(Assam got 1 crore per year) and other states such as Madras, Uttar Pradesh, Bihar, Madhya Bharat, Hyderabad, Rajasthan, Bombay, Madhya Pradesh and Pepsu were held to be in need of no financial assistance.The grants given by the Commission were not at all substantial being only a total sum of Rs.5.05 crores per year to seven states, of Rs.3.15 crores per year to four states[41] as grants in lieu of export duty on jute under Art.273 and Rs.9 crores as educational grant.

The Second Finance Commission generally endorsed the principles enunciated by the First Commission for payment of grants-in-aid[42]. The Second Commission was requested to take into account the requirements of the second five year plan and the scheme of the grants was to enable the states to have sufficient revenues to meet normal expenditure and their commitments in respect of the plan expenditure on revenue account.[43] As to the standard of severity of taxation as an

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22.40. See Report(1952),p.103. An amount of Rs-9 crores was given as grants-in-aid to eight states.This recommendation was adversely commented on by the Planning Commission. See Ashok Chanda, Federalism in India.(1965),p.202.

41.Assam(75)lakhs), Bihar(75 lakhs),Orissa (15 lakhs) and West Bengal(150 lakhs).

42.The Commission observed"The eligibility of a state to grants-in-aid and the amount of such aid should depend upon its fiscal need in a comprehensive sense". See Report Of The Finance Commission(1957),p.25.

43.See Report of The Finance Commission(1957), p.34.

adjustment, the Commission observed that it was difficult to decide the matter as an industrial state could raise higher revenue than an agricultural state with the same rate of taxation.[44] Hence a new test- whether a state has raised the revenue promised by it to beraised for the second five year plan- was adopted by the Second Finance Commission.The Second Commission also did not endorse the idea of helping the states to equalise the standards in social services and observed that it was the proper function of the planning commission and the National Development Council.[45] So far as this factor is concerned one cannot agree that to help certain states to conduct certain social services is not at all the function of finance commission. It may, if it thinks so, take into consideration the below standard social service in a state for recommending a grant but that it is different from giving a special grant to some states for that purpose.

~~The amount transferred~~

44. SeeReport(1957) p.24 The standard of severity of taxation only means that the states should have an above average effort to tap its taxable resources and not that every state should impose tax at the same rates.

45. However,the Commission took into account the expenditure under the second five year plan for raising the level of social service in so far as it had become committed expenditure. So the special conditional grant for primary education was discontinued. Instead, expenditure on unforeseen natural calamities was taken into account.

The amount transferred as grants-in-aid during the period[46] covered by the recommendations of the Commission was Rs.187.75 crores showing a four times increase than that of the period covered by the recommendations of the First Finance Commission.

The Third Finance Commission was mainly concerned with the overlapping and conflicting jurisdictions[47] of Finance Commission and Planning Commmission and even went to the extent of recommending the transformation of the Planning Commission into the finance commission at the appropriate time.[48] The

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46. Bombay, Madras and Uttar Pradesh received no grants. Bombay and Uttar Pradesh received the highest share by tax sharing, Rs.245.64 and 141.69 crores respectively. While Bihar, whose share was Rs.74.16 crores and Andhra Pradesh, whose share was Rs.70.05 crores in indivisible taxes obtained grants of Rs.20 and 21.16 crores respectively, Madras, whose share of divisible taxes was only Rs.72.88 crores received no grant. Mysore received the largest share of grant(Rs.30 crores) and Kerala received the smallest one (Rs.8.75 crores). Other states which received grants-in-aid were Assam(22.50 crores), Madhya Pradesh (15 crores), Orissa(10.20 crores) Punjab (11.25 crores), Rajasthan (12.50 crores), West Bengal(19.25 crores) and Jammu and Kashmir(15 crores).

47. See Report Of The Finance Commission(1961) pp.34.36

48. See Report(1961) p.36.The Chairman of the Commission A.K. Chanda states"This suggestion was not made out of pique but onmature consideration of the realities of the situation" See "The Financial Aspect Of Union- State Relations" III Journal Of Constl.And Parl.Studies,(1969)136,143. See also D.T;Lakdawala, Union State Financial Relations(1967) p.54 The Administrative Reforms Commission has recommended the inclusion of one of the members of the Planning Commission in the Finance Commission.See Report On Centre State Relations(1969)p.17. This has been accepted by the Government and Dr.B.S.Minhas,A member of the Planning Commission served in the Sixth Finance Commission.

observed that the reasons for the deteriorating financial position of the states were the impact of the committed expenditure of the completed plan porjects and the heavy expenditure for the upkeep and maintenance of non productive projects under the five year plans. The Commission thus proceeded to assess the fiscal need of states by taking into account 75% of the revenue component of the five year plan and recommended grants on that basis. But this was not accepted by the Government as such grants would be unconditional. Though the Commission revived the idea of specific grants for certain social services, as propounded by the First Commission, in making a grant for road development, it was done so by selecting the share of states on excise duty on petrol which was an item of tax sharing.[49] During the period of 4 years covered by the recommendations of the Third Finance Commission a total amount of Rs.244 crores has been given to states. The Commission

49. Whether such a recommendation was within the power of the Commission to make,is very doubtful. If the Commission wanted to give grants for any specific purpose,it ought to have been done not by taking legitimate revenue from the tax sharing pool.So strictly speaking this amount should not be taken into account in assessing the grants-in-aid given to the states.Rs.36 crores, were given to ten states.

recommended no grants-in-aid to Maharashtra, Punjab, Uttar Pradesh and West Bengal.[50] But three other states which obtained shares of above Rs.70 crores by tax devolution were given grants-in-aid.[51]

By the reference itself the Fourth Finance Commission[52] was required to have special regard to the expenditure devolving on the states for servicing of their debts in assessing fiscal need. The provision for grants to states for unforeseen natural calamities was liberalised. Another change introduced was that the Commission assumed that the interest due from public corporations to the state revenue was fully paid and also made no allowance for expenditure losses in state undertakings. The Commission expressed its disapproval to the scheme of grant for specific purposes as done by the first (for primary education) and third (for road development) Commissions. During the period of three years covered by the

50. These four States got the following amount by tax devolution Maharashtra(Rs.119.52 crores), Punjab (Rs.58.99 crores), Uttar Pradesh(Rs.147 crores) and West Bengal (93.72 crores).
51. They were Andhra Pradesh share of taxes(Rs.84.12 crores - grant Rs.38 crores) Madhya Pradesh(share of taxes Rs.74.81 crores-grant Rs.12 crores) and Madras,(share of taxes Rs.79.75 crores-grant Rs.12 crores). Then Madras received grant for the first time from the Third Commission.
52. The Fourth Commission also took exception to confining of the scope of its recommendations to the non plan revenue deficit in state budgets. See Report Of The Finance Committee Commission(1965), pp.6.10; also the minute by chairman P.V. Rajmannar, Ibid, pp.88.92. However the Administrative Reforms Commission reached the conclusion that it was prefectly legal. See Report on Central State Relations (1969), p.17.

recommendations of the Fourth Commission a sum of Rs.421.83 crores was given as grants to eleven states and five states[53] were given no grants as they were found to have surplus under the share of taxes.This time Uttar Pradesh received a grant of Rs.29.55 crores for the first time though it had received Rs.196.68 crores by way of tax sharing. Kerala[54] Mysore[55] Assam[56] and Orrissa[57] got increased grants of double the amount and Rajasthan[58] received an identical amount this time also.

The Fifth Finance Commission(1969) also accepted the principle that budgetary needs are important factors to deter-

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53. These were Maharashtra which got Rs.157.59 crores, Bihar which got Rs.120.61 crores, Gujarat which got 59.54 crores and West Bengal which got 118.33 crores by way of tax sharing.
54. Rs.62.46 crores Last time it got only Rs.25 crores.
55. Rs.62.46 crores Last time it got only Rs.27 crores.
56. Rs. 49.56 crores.Last time it got only Rs.24 crores.
57. Rs.87.54 crores Last time it got only Rs.53 crores.
58. Rs.20.19 crores. Last time it got only 21 crores. The respective amounts of other states are as follows: Grant received for 4 years under the previous Commissions is given in bracket.Andhra Pradesh,40.53(38); Jammu and Kashmir,19.71(8), Madhya Pradesh 8.10(12) Nagaland 21.21and Tamilnadu 20.52.(12).

mine the grants under Art.275. The Commission took into account expenditure on road maintenance, increase of dearness allowance of civil servants, food subsidies etc. Regarding tax effort made by a state, the Commission compared the tax revenue of each state with its level of percapita income. In relation to efforts of states for economy consistent with efficiency, the Commission compared the results with that of other states and also compared the level of expenditure on social services. The States of Bihar(199.46 crores), Gujarat(158.99 crores), Haryana (79.88 crores), Madhya Pradesh (15.09 crores), Maharashtra(419.29 crores) Punjab (117.22 crores) and Uttar Pradesh(280.87 crores) were found to have surplus by virtue of devolution of taxes and consequently no grant was recommended to these States.[59] The remaining ten states obtained grants of a total of Rs.637.85 crores. Thus the two States which have hitherto received no grant

59.	Andhra Pradesh	65.01 Rs.(crores)
	Assam	101.97
	Jamm & Kashmir	73.68
	Kerala	49.65
	Mysore	17.99
	Nagaland	77.95
	Orissa	104.67
	Rajasthan	51.49
	Tamil Nadu	22.82
	West Bengal	72.62
		637.85

are Maharashtra and Gujarat, the component States of the erst-while State of Bombay.

An evaluation of the working of the successive commissions on the area of financial grants will necessarily lead to an examination whether the poor states have received their lot. The two solvent states of the Indian Union according to the successive commissions are Maharashtra and Gujarat. We may examine some of the statistics of these two States with that of Punjab.[60]

States	Percapita income 1964-65.	Total tax revenue in 1967-68.	Percap-ita ta-xation.	Per capita expend-iture on	
				Education 1967-68	Public Health 1967-68
	Rs	Rs.crores	Rs.	Rs.	Rs.
Maharashtra	526	168.28	36.50	12.34	5.18
Gujarat	523	71.90	29.59	10.88	8.84
Punjab	575	50.20	37.46	15.79	4.48

Then the question may be asked whether States like Uttar Pradesh, Bihar and Madhya Pradesh which are generally re-cognized as backward areas could be equated with the above States for the purpose of denying grants to them as was done by the Fifth Finance Commission. The comparable Table for the above three States is as follows:

60.The source of the figures given in the table is the Finance Commission Report(1969)

States	Percapita income 1964-65	Total tax revenue in 1967-68.	Per capita taxation 1967-68.	Per capita expenditure on Education	Per capita expenditure on Public Health 1967-68.
	Rs	Rs.crores	Rs.	Rs.	Rs.
Uttar Pradesh	374	123.09	14.60	6.36	2.39
Bihar	299	64.29	12.06	4.98	1.67
Madhya Pradesh	373	63.54	16.94	10.57	3.68

As regards per capita income these latter States stand at eleventh,Sixteenth and twelth positions, as regards per capita taxation they stand at fourtseenth, sixteenth and thirteenth positions, as regards per capita expenditure on education their respective positions are fifteenth, sixteenth and twelfth and as regards per capita expenditure on public health their respective positions are fifteenth, sixteenth and thirteenth. Thus State of Bihar has the lowest position in per capita income, per capita expenditure on social services such as education and public health and the position of the two other states are only slightly better. The facts shown above reveal that these three states cannot at all be compared with the first three states. Then if they are denied any grants by the Commission it cannot be because of their poor standard but could only be on other grounds.The reason stated by the Commission is that they have available surplus after the shares alloted to them under the tax devolution scheme. This is possible as these three states with their larger population[61] would have obtained the lion's share[62] in the tax devolution scheme. The Fifth Finance Commission[63] has stated that by the principles adopted to distribute sharable taxes some of the States-Bihar, Gujarat, Haryana, Madhya Pradesh, Maharashtra, Mysore[64], Punjab and Uttar Pradesh were found to have surplus during the five years of an amount of Rs.1273.38 crores. Among these States, Haryana, Maharashtra and Punjab were stated to have revenue surplus even without devolutions[65]. The Commission also stated that the deficits in Bihar and Uttar Pradesh were much smaller than the devolutions which these two states got under the scheme.

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61. U.P. and Bihar stand as first and second and Madhya Pradesh stands as the seventh populous state in India.
62. As regards income tax these states account for 33% which is greater than the total shares of 9 states like Assam, Gujarat, Haryana, Jammu & Kashmir, Kerala, Orissa, Punjab, Rajasthan and Mysore which only come to 30.19%, as regards excise duty these three states account for 41.11% which is greater than the total shares of 10 other states like Assam, Gujarat, Haryana, Jammu & Kashmir, Kerala, Mysore, Orrisa, Punjab, Rajasthan & West Bengal which only come to 37.23%.
63. Report of the Finance Commission(1969), p.65.
64. Mysore was however given a grant. See Ibid p.65.
65. See Ibid p.66.

So the position clearly emerges that the only states which are financially in better standards with or without the devolution scheme are Maharashtra, Punjab and Haryana. Two other states which may be classified with their shares in tax devolution scheme are Bihar and Uttar Pradesh with their lowest levels of expenditure on social services.The other states are nowhere near these five states and the commissions have failed to neutralise the inequalities during these twenty years. For example, the State of Kerala which makes a very good tax[66] effort and keeps a high level of social service expenditure[67] gets very low share in the devolution scheme[68] but has been given a grant of only Rs.49.65 v crores for 1969-1974. Assam is another backward state, which has low[69] levels of per capita taxation, expenditure on social services gets a low

66. The per capita taxation in 1967-68 is Rs.27.44
67. The per capita expenditure during 1967-68 on education is Rs.21.11 and that on public health is Rs.6.42. It has been observed "with few exceptions the states lowest in financial ability are making the greatest relative effort to support public education. The poorer areas usually show the highest birth rates and the underprivileged individuals migrate in later life to areas of greater economic opportunity" Report Of The Committee On Inter Governmental Financial Relations(Washington, 1943) cited in Findlay Shirass, Federal Finance in Peace And War op.cit., p.227.
68. Kerala's share of income-tax is 3.83% and that of excise duty is 4.28% under the Fifth Commission Report i.e.only Rs.183.13 crores.
69. The percapita taxation in 1967-68 was Rs.18.66. The per capita expenditure on education was Rs.12.57 and that on public health was Rs.4.12 for 1967-68.

percentage of shareable taxes.[70] But Assam gets a grant of Rs.101.97 crores, more than double of what was awarded to Kerala. The point is not that Assam is not in need of that amount but that such glaring disparities ought to have been avoided[71] by the Commission. To say the least, the States like Kerala, Assam, Orissa and Rajasthan have nothing much to be differentiated.The reports of the successive finance commissions are silent as to the exact formula applied to arrive at these fixed sums given as grants-in-aid. Had the commission published the figures much of the criticism could have been avoided. The reports only show abundance of general principles and nothing by way of how they were applied in real practice. The formula applied to assess ecnomic backwardness should be precise and uniform.

In these respects the Report of the Sixth Finance Commission is really helpful. The Commission was bound by the terms of reference to have regard to considerations like(a) existing practice in regard to determination and distribution of central assistance for financing state plans,(b) revenue resources of the states on the basis of level of taxation

70. The shares Assam got were-incometax 2.67% and excise duty 2.5% i.e. Rs.109.91 crores.
71. The case of Orissa also may be cited here; the per capita taxation in that state for 1967-68 was Rs.12.12, the per capita expenditure on education was Rs.7.97 and that on public health was Rs.381 for the year 1967-68. Orissa got a grant of Rs.104.67 crores and by tax devolution Rs.182.70 crores.

likely to be reached by 1973-74,(c) requirements on revenue account to meet expenditures for revision of emoluments of government employees, interest charges on debts, etc., (d) expenditure for adequate maintenance and w upkeep of capital assets, etc.,(e) for the advancement of general administration of backward states and (f) the scope for better fiscal management and economy consistent with efficiency which may be effected by the states in their administrative, maintenance, developmental and other expenditure.

The Sixth Commission has given the complete data in relation to each state and how the budgets of different states have been put on a comparable basis.The scheme adopted by the Commission was to find out the revenue receipts first. Then the non-plan expenditure both developmental and non-developmental on revenue account is assessed. The variations made by the Commission on the estimate supplied by the state governments are separately noted. The developmental expenditure includes provisions for education, medicine, public health and maintenance for roads and buildings.[72] The subtraction of the non-plan expenditure on revenue account from the total revenue receipts gives the non-plan revenue gap.[73] From this amount the estimated amount for revision of pay of state government employees is subtracted. The figure thus arrived at represents the non-plan revenue(surplus or deficit) excluding the amount to which the state is entitled to under the scheme for devolution of e central taxes. Such amount the state

72.See Report (1973),Ch.IX.
73.See Report (1973),Ch.X.

gets by way tax devolution is added to the amount last mentioned. To this figure, the commission adds the amounts provided for upgradation of standards of essential administrative and social services.[74] The balance figure so arrived at, if a deficit, is awarded as grant-in-aid under Art.275. On the basis of this calculation[75] seven states were found to have surplus and received no grant. Fourteen states received grants-in-aid for five years as shown below- Andhra Pradesh(205.93 crores), Assam(254.53 crores), Bihar (106.28 crores), Himachal Pradesh(160.96 crores), Jammu & Kashmir (173.49 crores), Kerala(208.93 crores), Manipur (114.83 crores), Meghalaya (74.67 crores), Nagaland(128.84 crores), Orissa(304.73 crores), Rajasthan(230.53 crores), Tripura(112.50 crores), Uttar Pradesh (198.83 crores) and West Bengal(234.86 crores). It could be seen that Karnataka (formerly Mysore) which was a recipient of grant under the award of the Fifth Commission has not received any under the recommendation of the Sixth Commission and Uttar Pradesh, which received no grant last time became entitled to one. Again it could be seen that the grants-in-aid recommended by the Commission are of substantial amounts of Rs.2509.61 crores as against Rs.637.85 crores awarded by the Fifth Commission.

74.This included provisions for upgradation of standard of general administration, justice, jail etc. See Report (1973),Ch.XII.

75.They are Gujarat(+335.46 crores),Haryana(+223.35 crores), Karnataka(+ 232.74 crores), Madhya Pradesh(+110.18 crores), Maharashtra(+ 748.42 crores), Punjab(+341.48 crores), and Tamilnadu(+184.53 crores).

Under the procedure adopted by the Sixth Finance Commission to provide for upgradation of standards of administration, the states which have maintained low levels of services have benefited much.[76] In such cases the Commission has worked out[77] the national average and the minimum that is required for its attainment in the case of states which have a too low figure than the average. This is understandable and unavoidable. In India, the calculation is made on the basis of national average for all such services separately like police, primary education, public health etc. and not as is done in Australia, where the Commonwealth Grants Commission ascertains the need by comparison with the levl of standards available in non claimant standard states. As a workable test, the course adopted by the Sixth Finance Commission is more suited to the conditions in India. Then the only question which remains is the problem of those poor states, which have an above average per capita expenditure on these services.[78] Are they to be penalised for an above national average expenditure?[79] It seems that the Finance Commission has in such cases included the actual expenditure for the purpose of calculation. Hence the method adopted by the Finance Commission is the best available in the present ~~sixm~~

76. For example the provision for Uttar Pradesh is 290.16 crores and that for Bihar is 166.79 crores.
77. See Appendix XII of the Report(1973).
78. For example the average per capita expenditure on primary education is Rs.57.20. The State of Assam has an average of Rs.161.30 and the State of Kerala has an average of Rs.132.20.
79. See Report of the Finance Commission(1973), p.69.

circumstances.[80]

One of the main reasons for the failure of finance commission lies in its lack of understanding of the nature of the work done by its counterpart- Commonwealth Grants Commission in Australia.The Fifth Commission had observed[81]"This body, however is not constituted under the Australian Constitution but by a Commonwealth law. It has no power to suggest changes in tax sharing or to recommend conditional grants. Its functions are confined to recommending unconditional grants for a few States". This failure to acknowledge the practical wisdom garnered by the Grants Commission in the area of federal finance especially as to the problem of assessing the fiscal need of a state has caused the finance commission to leave the matter to speculation. What is suggested is not a wholesale importation of the principles applied there but the need to examine whether they could be adopted, improved or discarded. For example, the concept of "Standard states"would have minimised the difficulty of the commission to evaluate the comparative claims of different states.The budgets of all the states, the standard states and that of the "poor states" should be worked out on a comparable basis.The failure of the commission to put the formula for grants -in-aid on more

80.The Commission has also provided for the non diversion of such funds for some other purpose. See Ibid at 68. But, it is submitted, such a course would change the nature of grants-in-aid into conditional grants.

81.See Report Of The Finance Commission(1969) p.10.The First Finance Commission was much influenced by the principles followed by the Commonwealth Grants Commission.See Report of the Finance Commission(1952) p.94; See also Report by B.K.Nehru and B.P.Adarkar on the Australian System Of Federal Finance And Its Applicability to Indian Conditions (1947).

concrete and simple grounds has left the whole picture far from clear and bordering on speculation.[82]

Some other anomalies which have crept into the calculations of the finance commission may be briefly noted here. Firstly, the commission takes into account only the committed expenditures by states and so states which start any expenditure on any scheme after the recommendation of a commission have to wait till the next commission starts its work. Secondly, if the finance commission gives due weight to tax severity-tax effort by a state commensurate with its taxable capacity-it would curb the present tendency in certain states to abolish land revenue and to impose prohibition on liquor and thus lose the excise revenue. This is important because the states should not be encouraged to enlarge their budgetary deficits by taxing less and spending more.

The Problem Of Debt Liabilities Of States.

The growing burden of debt charges on state budgets is another disturbing feature. A major portion of the money transferred to the state is now used for repayment of loans and interest, to the Central Government itself. The Fourth Finance Commission provided for a sinking fund for the discharge of public debt as a legitimate charge on revenue account. But it is surprising to see that out of an amount of Rs.286.20 crores which was set apart for this purpose about 70% was

82. A lot of statistics is necessary for this, the dearth of which was pointed out by successive commissions. See D.T. Lakdwala, Union- State Financial Relations (1967), P.75.

distributed among five states alone. The Fifth Finance Commission also provided for amortisation of state debts used for non-revenue yielding purposes. The conventional view is that the state should raise loans to finance capital projects[83] and it is "unfair to ask the tax payers of a single year to bear the entire burden of works which will be a source of profit as well as a benefit to the community over a period of years".[84] According to the orthodox view, all expenditure on non-revenue producing schemes should be met out of revenue or income and in no case to be incurred from capital, however strong a sinking fund may be established.[85] Large amounts of loan have been invested in projects which are either non-productive or inefficiently administered so as to run on loss.[86] Another reason of indebtedness of states is, as shown by the Second Finance Commission, the discretionary grants given by Central

83. Capital projects may be defined as long term investment programmes with benefit spread over the future years.
84. See Findlay Shirass, The Science Of Public Finance,op.cit. p.162. In such cases, loans should be fixed within such limits as will make the payment of interest and the gradual repayment of the principal over a stated period, i.e., by the operation of a sinking fund, a certainty. See Ibid at p.163.
85. Ibid at 170.
86. "Unfortunately the old financial productivity criterion has been much blurred without the emergence of a new one", observes D.T.Lakadawala, Union-State Relations(1967), p.108.

Government on a matching basis.This results in plunging the states into rash extravagance and heavy indebtedness under the compulsion of raising large sums to qualify for central grants. This has indeed distorted states' budgets and legislative programmes by diverting state money into those channels where central funds are available.[87]

The Sixth Finance Commission has made a detailed study of the subject.The outstanding loans payable to the Government of India by states were classified into non plan and plan loans.[88] The objective was two fold, firstly to determine afresh the period of repayment of different categories of loans with due regard to the nature of the scheme and the relative debt burden of the states and secondly to enable the statds to have a reasonable fifth five year plan by mitigating the burden of repayment during that period. The periods of repayment have been extended considerably in almost all cases and the states were divided into three categories for this purpose.[89] The Table[90] given by the Commission shows the estimated relief to the states on the basis of the proposals.

87. See Report of Finance Commission(1957),pp.68-69; See also Benjamin N.Schoenfeld, Federalism in India (Washington,1960).
88. See Report of The Finance Commission(1973), p.85
89. Ibid at 93.
90. Ibid at 95.

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