CHAPTER XV

TRADE, COMMERCE AND INTERCOURSE

SYNOPSIS

A. INTRODUCTORY

Trade, commerce and intercourse may be domestic or foreign or international. Arts. 301-305, discussed in this Chapter, deal with domestic trade and commerce, *i.e.*, within the territory of India. Such commerce may be of two types—(i) intra-State, *i.e.*, commerce which is confined within the territory of a State; (ii) inter-State, *i.e.*, trade and commerce which overflows the boundary of one State and which extends to two or more States.

No federal country has an even economy. Some of its constituent units may be agricultural while others may be industrial. Some States may produce raw mate-

rials while the processing and manufacturing industries may be located in other States because of several favourable factors, like availability of cheap labour or electric energy. This circumstance creates the possibility that the constituent units which have legislative powers of their own may, to serve their own narrow and parochial interests, seek to create trade barriers by restricting the flow of commodities either from outside or to other units.

Creation of such regional trade barriers may prejudicially affect national interests as it may hamper the economic growth of the country as a whole, and this would be disadvantageous to all the units in the long run. Besides, the resources and industries of the units may be complimentary to each other. Free flow of trade, commerce and intercourse within a federal country having a two-tier polity is a pre-requisite for promoting economic unity of the country. An attempt has, therefore, been made in all federations, through adopting of suitable constitutional formulae, to create and preserve a national economic fabric, transcending State boundaries, to minimise the possibility of emergence of local economic barriers, to remove impediments in the way of inter-State trade and commerce and thus help in welding the whole country into one single economic unit so that the economic resources of all the various regions may be exploited, harnessed and pooled to the common advantage and prosperity of the country as a whole.[1]

Federalism, therefore, has come to connote one big common internal market and an economic area irrespective of the State boundaries. This preferred national goal has provided the motive force, in part, for the creation of the federations of the U.S.A. Canada and Australia.[2]

B. POSITION IN OTHER COUNTRIES

The most significant provision in the U.S.A., for this purpose, is the Commerce Clause,[3] which provides *inter alia* that the Congress shall have power to regulate commerce among the several States. The clause does not in terms restrict State protectionism, but by a process of judicial interpretation, it has come to have a restrictive effect on the States in those matters in which the Supreme Court considers that uniformity is necessary for national economic well being, and, thus, the capacity of the States to interfere with inter-State commerce has been very much restricted.[4] The Commerce Clause has also bestowed on the Central Government necessary power to regulate the country's economy. The Courts have interpreted the words 'inter-State commerce' in a broad sense, and have held that the Congress can regulate not only inter State commerce but even those intra-State activities which so affect inter-State commerce as to make their regulation appropriate.[5]

In Canada, the Provinces have been deprived of the power to levy indirect taxes so that they may not be able to create interprovincial trade barriers.[6] This

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1. Bowie, *Studies in Federalism*, 296-357 (1954).
2. Also see, *supra*, Ch. X, Sec. L; Ch. XI, Sec. I; Ch. XI, Sec. J(ii).
3. Art. 1, Sec. 8, Cl. 3 of the U.S. Constitution.
4. *Cooley v. Port Wardens*, 12 How 299; *Southern Pacific Co v. Arizona*, 325 US 761 (1945); *Bibb v. Navajo Freight Lines*, 359 US 520.
5. *Supra*, Ch. X.
6. Royal Comm., *Report*, 30 (1939).
Also, *supra*, Ch. XI, Sec. I.

has been further strengthened by making "regulation of trade and commerce" a Central matter, but as already seen, this Central power has not played much meaningful role so far.[7] Then, Sec. 121 of the BNA Act, which provides that "articles of growth, produce or manufacture of any province shall be admitted free into each of the other provinces", also curtails the provincial power to put restrictions on entry of goods from other provinces.

In Australia, with a view to promoting the economic unity of the country, and discouraging the States from raising trade barriers, the States have been debarred from levying excises.[8] The crucial provision, however, for the purpose in the Australian Constitution is Section 92 according to which trade, commerce, and intercourse among the States shall be absolutely free. The clause applies only to inter-State and not to intra-State commerce, and restricts both the States and the Centre from interfering with trade and commerce.[9]

Literally, the scope of Section 92 is unlimited and unqualified, but, as no freedom can be absolute, Courts have evolved some limitations on this freedom as well. It has therefore been laid down that some regulation of inter-State trade, commerce and intercourse is compatible with its absolute freedom, and that Section 92 is violated only when a legislative or executive act operates to restrict inter-State trade, commerce and intercourse directly and immediately and not when it creates "some indirect or inconsequential impediment which may fairly be regarded as remote."[10] Thus, laws to ensure public health and honesty and fairness in commercial dealings are not voided by the concept of freedom of inter-State trade and commerce.[11] But such a law should not have an impact which is "reasonably unnecessary" upon the activities of the individual in inter-State trade and commerce. Legislation of a regulatory nature has generally been upheld, but not prohibitory legislation. Thus, a State law requiring a person operating in inter-State commerce to apply for a licence, but conferring on the concerned officer an uncontrolled discretion to grant or refuse the licence has been held to be bad, as giving uncontrolled discretion to the licensing authority is prohibitory and not regulatory.[12]

The same approach is seen in the judicial attitude towards nationalization. The Central Government's attempt to create a monopoly for the government airline by prohibiting private airlines from operating inter-State,[13] the prohibition on private banking from engaging in inter-State commerce,[14] have been held to be bad. Section 92 guarantees the freedom of the individuals. The Courts have rejected the argument that the test of 'volume of trade' flowing from State to State should be adopted to adjudge whether a restriction is bad under Section 92, or that it protects only the passage of goods, or that it would apply only when the freedom is impaired at the frontier. A restriction applied not at the State borders

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7. *Supra*, Ch. X, Sec. L.
8. *Ibid.*
9. *Jindal Stainless Ltd. (2) v. State of Haryana*, (2006) 7 SCC 241, at page 263 : AIR 2006 SC 2550.
10. *Commonwealth of Australia v. Bank of New South Wales*, 1950 AC 235.
Also, *Permewan Wright Consolidated Pty. Ltd. v. Trewhitt*, 27 ALR 182.
11. *S.O.S. (Mowbray) Pty. Ltd. v. Mead*, (1972) 124 CLR 529; *Clark King v. Australian Wheat Board*, (1978) 21 ALR 1.
12. *Hughes and Vale Proprietary Ltd. v. New South Wales*, 1955 AC 241.
13. *Australian National Airways v. The Commonwealth*, 71 CLR 29.
14. *Supra*, footnote 10.

but at a prior or subsequent stage of inter-State trade, commerce or intercourse, can also offend against Section 92.

The test of 'directness' of restraints applied in earlier cases[15] in Australia was rephrased in some later cases, *viz.*, a law which imposes a restriction, burden or liability by reference to, or in consequence of, a fact or an event or a thing itself forming part of inter-State trade, commerce, or intercourse, or forming an essential attribute of that concept, essential in the sense that without it you cannot bring into being the particular example of inter-State trade, commerce or intercourse, contravenes Section 92 if it creates a real prejudice or impediment to inter-State transactions. For applying the test, it is necessary to distinguish an 'essential' of inter-State trade, commerce, or intercourse from a 'non-essential' or a mere incident. This is a technical distinction and at times it may be very difficult to distinguish between the 'essential' and the 'incidental'. The test however is somewhat flexible and vague for such terms as 'essential', 'incidental', 'real prejudice' have a variable and not a fixed connotation and are difficult to apply in specific situations.[16]

In a later case,[17] the High Court of Australia reverted to the test laid down in *Bank of New South Wales*[18] and held that economic consequences of a law operative upon inter-State trade and commerce cannot be ignored. The proposition that the economic result produced by an Act is not within its direct operation is not valid. Economic results produced by an Act cannot be held to be irrelevant in determining whether the Act leaves trade and commerce free. The Courts have also propounded the thesis that inter-State commerce must pay for the facilities it uses, such as bridges, aerodromes, highways etc. But a distinction is drawn between a charge for the facility provided and one which would be a deterrent to trade. The charge levied should be a 'fair' recompense for the actual use made of the facility. For example, in case of highways, the charge can be levied only for their maintenance, and not to meet the capital cost of their construction, and the charge should be computed with reference to such factors as mileage for which the highway is used, and the weight and load-capacity of the vehicle.[19]

C. POSITION IN INDIA

The Constitution-makers desired to promote free flow of trade and commerce in India as they fully realized that economic unity and integration of the country provided the main sustaining force for the stability and progress of the political and cultural unity of the federal polity, and that the country should function as one single economic unit without barriers on internal trade.

Economic unity of India is one of the constitutional aspirations and safeguarding its attainment and maintenance of that unity are objectives of the Indian

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15. As for example, the *Bank Nationalization case*, note 9, *supra*.

16. See, *Hospital Prov. Fund v. Victoria*, 87 CLR 1 (1953); *Hughes and Vale case*, (II), 93 CLR 127 (1955); *Russell v. Walters*, 96 CLR 177 (1957); Ross Anderson, Freedom of Interstate Trade: Essence, Incidence and Device under S. 92 of the Constitution, 33 *Australian LJ* 294 (1959); Sawer, *Cases on the Constitution of the Commonwealth of Australia*, 232-423 (1982); Coper, *Freedom of Interstate Trade under the Australian Constitution* (1983).

17. *North Eastern Dairy Co. v. Dairy Industry Authority*, 50 ALJR 121, 129 (1976).

18. *Supra*, footnote 10.

19. *Commonwealth Freighters v. Sneddon*, 102 CLR 280; *Armstrong v. State of Victoria*, 99 CLR 28.

Constitution. In order to ensure that the State Legislatures subjected to local and regional pulls do not create trade barriers in future, Arts. 301-305 have been incorporated into the Constitution. These provisions deal with trade, commerce and intercourse within the territory of India—whether intra-State or inter-State. The main provision is Art. 301.

The Supreme Court has explained in detail the motivations and aspirations of the framers of the Constitution in drafting Arts. 301-305 in *Atiabari*[20] in the following words:

> "In drafting the relevant Articles [Arts. 301-305] the makers of the Constitution were fully conscious that economic unity was absolutely essential for the stability and progress of the federal polity which had been adopted by the Constitution for the governance of the country. Political freedom had been won, and political unity which had been accomplished by the Constitution, had to be sustained and strengthened by the bond of economic unity. It was realised that in course of time different political parties believing in different economic theories or ideologies may come in power in the several constituent units of the Union and that may conceivably give rise to local and regional pulls and pressures in economic matters. Local or regional fears or apprehensions raised by local or regional problems may persuade the State legislatures to adopt remedial measures intended solely for the protection of regional interests without due regard to their effect on the economy of the nation as a whole. The object of [Arts. 301-305] was to avoid such a possibility. Free movement and exchange of goods throughout the territory of India is essential for the economy of the nation and for sustaining and improving living standards of the country."

The Court has again dilated on this theme in *Automobile Transport*:[21]

> "There were differences of language, religion, etc. Some of the Provinces were economically more developed than the others. Even inside the same province there were under-developed, developed and highly developed areas from the point of view of industries, communications, etc. The problem of economic integration with which the Constitution-makers were faced was a problem with many facets. Two questions, however, stood out. One question was how to achieve a federal, economic and fiscal integration, so that economic policies affecting the interests of India as a whole could be carried out without putting an ever increasing strain on the unity of India, particularly in the context of a developing economy. The second question was how to foster the development of areas, which were under-developed without creating too many preferential or discriminative barriers."

The scheme of Arts. 301-305 is somewhat complex. There is a mix up of exceptions upon exceptions in these provisions. Therefore, to have an idea of the extent of freedom granted to trade and commerce, and the limitations imposed thereon, all these constitutional provisions must be considered together. According to the Supreme Court,[22] in evolving these provisions, the framers of the Constitution seem to have kept three main considerations in their view. One, in the larger interests of the country, there must be free flow of trade, commerce and intercourse, both inter-State and intra-State. Two, the regional interests must not be ignored altogether. Three, the Centre should have power of intervention in any

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20. *Atiabari Tea Co. Ltd. v. State of Assam*, AIR 1961 SC 232, 247 : (1961) SCR 809.
21. *Automobile Transport (Rajasthan) Ltd. v. State of Rajasthan*, AIR 1962 SC 1406 : 1963 (1) SCR 491.
22. *Ibid.*, at 1416.

case of crisis to deal with particular problems which may arise at times in any part of India.

According to Art. 301, "trade, commerce and intercourse throughout the territory of India shall be free."[23] This constitutional provision imposes a general limitation on the exercise of legislative power, whether of the Centre or of the States, to secure unhampered free flow of trade, commerce and intercourse from one part of the territory to another. The purpose underlying Art. 301 is to promote economic unity of India and that there should not be any regional or territorial economic barriers.

The origins of Art. 301 may be traced directly to Section 92 of the Austalian Constitution, but there are some significant differences between the two provisions.

(1) Section 92 of the Australian Constitution immunizes inter-State trade only as the words used therein are "among the States". On the other hand, Art. 301 uses the words "throughout the territory of India". This means that Art. 301 covers both inter-State and intra-State trade. Therefore, the coverage of Art. 301 is broader than that of Section 92.

A reason to include both 'inter-State' and 'intra-State' commerce within Art. 301 may be that at times it becomes difficult to draw a line of demarcation between the two as these may be so inextricably mixed up that control of one may result in the control of the other as well.[24]

(2) Section 92 makes freedom of trade 'absolutely' free, whereas Art. 301 omits the word 'absolutely'. This is for a good reason *viz.* that no freedom can be absolute. Even in Australia, the freedom is not 'absolute' but 'regulated' and 'relative'.

(3) Section 92 is worded generally and contains no exceptions. It has been for the Courts to spell out the restrictions on it. In India, on the other hand, the exceptions to Art. 301 have been laid down in Arts. 302-305. The total impact of these exceptions is to make the position in India quite different from that in Australia in the area of freedom of trade and commerce.

(4) In Australia, the restriction applies both to the Centre as well as the States. In India, on the other hand, while the restraint applies formally both to the Centre and the States, the scheme of the constitutional provisions (Arts. 302-304) is

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23. See, generally, Derham, Some Constitutional Problems arising under Part XIII of the Indian Constitution, 1 *JILI*, 523, 551; A note in the same journal at 190; Rice, Division of Powers to control Commerce, 1 *JILI*, 151 (1959); Ramaswami, Indian Constitutional Prov. against Barriers to Trade and Commerce, 2 *JILI*, 320 (1960); VII CAD, 800-803; X CAD, 348; IX CAD, 1126 et seq.; Ebb, *Interstate Barriers in India and American Constitutional Experience*, 11 *Stan, LR.*, 37 (1958-59); S.N. Jain, Freedom of Trade and Commerce and Restraints on the State Power to tax Sale in the course of Interstate Trade and Commerce, 10 *JILI*, 547 (1968); M.P. Singh, Prohibition against preference on Discrimination in Trade and Commerce, 3, *JI. Bar Council of India*, 278 (1974); D.K. Singh, Trade, Commerce, and Intercourse in India; A Reappraisal of Constitutional Problems, 14 *JILI*, 39 (1972). See further *Jindal Stainless Ltd. (2) v. State of Haryana (supra)*, at page 263 "Article 301 is inspired by Section 92 of the Australian Constitution when it refers to freedom of trade and commerce, however, Article 301 is subject to limitations and conditions in Articles 302, 303 and 304 which are borrowed from the commerce clause under Article 1 of the US Constitution".

24. *Supra*, pp. 1052-53.

such that, in effect, the Centre can dilute the restraint by its own legislative action but the States remain subject to the control of the Centre in this respect.

In Australia, the commerce clause has hampered the governments in pursuing many economic programmes so very essential in a modern country for promotion and expansion of economy. India steers clear of such difficulties, as the scope of the freedom of trade and commerce can by and large be adjusted by legislative action.

Besides Art. 301, the concept of economic unity is also strengthened by the scheme of allocation of powers between the Centre and the States.[25] The Centre has been given broad powers in the economic field. Inter-State trade and commerce is an exclusive Central matter and the States have power only on intra-State trade and commerce which again is subject to entry 33, List III.[26] Further, inter-State sales tax belongs to the Centre and the States' power is confined to levying tax only on intra-State sales.[27] The excise duties can also be levied largely by the Centre and not the States.[28]

INTER-RELATION BETWEEN ARTS. 19(1)(G) AND 301

Article 19(1)(g), a fundamental right, confers on the citizens the right to practise any profession or carry on any occupation, trade or business subject to reasonable restrictions in public interest.[29] The question of inter-relationship between Arts. 19(1)(g) and 301 is somewhat uncertain.

One view is that while Art. 19(1)(g) deals with the right of the individuals, Art. 301 provides safeguards for the carrying on trade as a whole distinguished from an individual's right to do the same.[30] This view, however, is hardly tenable. Art. 301 is based on Section 92 of the Australian Constitution which has been held to comprise rights of individuals as well,[31] and the same should be the position in India. In actual practice, this view has never been enforced and individuals have challenged legislation on the ground of its effect on their right to carry on trade and commerce. The Supreme Court has denounced the theory that Art. 301 guarantees freedom "in the abstract and not of the individuals."[32]

Another way of projecting the same idea is to say that Art. 301 aims at preventing restrictions on the volume of trade flowing and, therefore, the effect of a law on individuals is irrelevant. Under this view, if ample provision is made for carrying on trade, and the volume of the trade remains as before, the mere fact that certain individuals have been prohibited from taking part therein would not contravene Art. 301.

But this view creates many difficulties. To ascertain the volume of trade before and after the impugned statute, it would be necessary to refer to various

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25. *Supra*, Ch. X.
26. *Supra*, Ch. X, Sec. F.
27. *Supra*, Ch. XI, Secs. D and J(i).
28. *Supra*, Ch. XI, Secs. C and D.
29. *Infra*, Ch. XXIV, Sec. H.
30. Reference has been made to this view, without finally deciding, by Mukherjea, J., in *Saghir Ahmad v. State of U.P.*, AIR 1954 SC 728, 742 : 1955 (1) SCR 707; Das, CJ., in *State of Bombay v. Chamarbaugwalia*, AIR 1958 SC 699; Wanchoo, C.J., in *Automobile Transport v. State of Rajasthan*, AIR 1958 Raj 114.
31. *Commonwealth of Australia v. Bank of New South Wales*, 1950 AC 235.
32. *Dist. Collector, Hyderabad v. Ibrahim*, AIR 1970 SC 1275 : (1970) 1 SCC 386.

complicated socio-economic factors, data and statistics, and the Courts avoid such questions as they are hardly the proper forum to go into these matters. The test of total volume has been criticised in Australia as "unreal and unpractical", for it is "unpredictable whether by interference with the individual flow the total volume will be affected, and it is incalculable, what might have been the total volume but for the individual interference."[33] Therefore, the volume of trade theory is also untenable.

A difference between Arts. 19(1)(*g*) and 301, it has been said, is that Art. 301 could be invoked only when an individual is prevented from sending his goods across the State, or from one point to another in the same State, while Art. 19(1)(*g*) can be invoked when the complaint is with regard to the right of an individual to carry on business unrelated to, or irrespective of, the movement of goods,[34] *i.e.*, while Art. 301 contemplates the right of trade in motion, Art. 19(1)(*g*) secures the right at rest.[35]

It is true that the 'movement' aspect of commerce is of great importance, and that one of the dominant purposes underlying Art. 301 is to keep inter-State movement of goods and persons free and unhampered. It is also true that the Supreme Court has placed emphasis on the movement aspect.[36] Nevertheless, it is difficult to accept the theory that Art. 301 is limited only to movement and not to trade at rest. The concept of 'trade at rest' has been countered by the Statement that "there is no rest for the businessmen; the essence of intercourse is coursing not sitting....."[37] There have been quite a few cases in which Courts have scrutinised under Art. 301 such aspects of trade, commerce and intercourse which may be regarded as "commerce at rest" and not "in motion".[38]

There thus appears to be no satisfactory way to explain the relation of the two Articles. A restriction on trade and commerce can be challenged under both these constitutional provisions. However, Art. 301 covers many interferences with trade and commerce which may not ordinarily come within Art. 19(1)(*g*), as for instance, levy of octroi. Freedom of trade and commerce is a wider concept than that of an individual's freedom to trade guaranteed by Art. 19(1)(*g*).

Article 19(1)(*g*) can be taken advantage of by a citizen, while Art. 301 can be invoked by a citizen as well as a non-citizen. Also, while Art. 19(1)(*g*) is not available to a corporate person, Art. 301 may be invoked by a corporation and even by a State on complaints of discrimination or preference which are outlawed by Art. 303, discussed below. In emergency,[39] Art. 19(1)(*g*) is suspended and so Courts may take recourse to Art. 301 to adjudge the validity of a restriction on commerce. In certain situations, only one of the two may be relevant, as for example, when there is no direct burden on a trade but it may be a restriction in terms of Art. 19(1)(*g*) read with Art. 19(6).

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33. *Supra*, footnote 30 above.
34. *Bapubhai v. State of Maharashtra*, AIR 1956 Bom 21; *Usman v. State*, AIR 1958 MP 33.
35. *Motilal v. State of U.P.*, AIR 1951 All 257. Also, *Saghir v. State of U.P.*, AIR 1954 All 257 and AIR 1954 SC 728 : (1955) 1 SCR 707; *Hotel Association of India v. Union of India (UOI)*. In The High Court of Delhi (Writ Petition (Civil) No. 4692/1999 -decided On: 12.01.2006).
36. *Atiabari Tea Co. v. State of Assam*, AIR 1961 SC 232 : (1961) 1 SCR 809; *Hansa Corp., infra*.
37. Rice, footnote 23, *supra*.
38. See, Sec. D., *infra*, under "*Trade, Commerce and Intercourse.*"
39. *Supra*, Ch. XIII, Secs. A and B.

In some other situations, both provisions may become applicable and it may be possible to invoke them both. Economic situations and conditions being unpredictable, it is not necessary to evolve any conceptualistic differentiation between the two Articles. Art. 301 is a mandatory provision and a law contravening the same is *ultra vires*, but it is not a Fundamental Right and hence is not enforceable under Art. 32.[40] But if the right under Art. 19(1)(*g*) is also infringed, then Art. 32 petition may lie.

There are three alternative situations:

(*i*) A provision may be valid under Arts. 301 to 304, but may be invalid under Art. 19(1)(*g*); or

(*ii*) it may be invalid under Arts. 301 to 304 as well; or

(*iii*) it may be invalid under Arts. 301-304, but not under Art. 19(1)(g) situations.

Article 32 petition will lie in situations (*i*) and (*ii*), but not in situation (iii).[41]

D. CONTENT OF ART. 301

Commenting on Art. 301, the Supreme Court has observed in *Atiabari*[42] that Art. 301 "is not a declaration of a mere platitude, or the expression of a pious hope of a declaratory character; it is not also a mere Statement of a Directive Principle of State Policy;[43] it embodies and enshrines a principle of paramount importance that the economic unity of the country will provide the main sustaining force for the stability and progress of the political and cultural unity of the country….."

The makers of the Constitution were fully conscious that it was absolutely essential to promote economic unity for the stability and progress of the federal polity in India.

The framers of the Constitution realized that in course of time different political parties having different economic programmes may come in power in different States. This may generate local and regional pulls and pressures in economic matters. The State Legislatures may be swayed, in response to local pressures, to take measures to take care of regional interests without any regard to their impact on the national economy as a whole. The object of Art. 301 is to obviate any such possibility and to ensure free movement of goods throughout the Indian territory which is essential for developing a national economy.

The scope and content of Art. 301 depends on the interpretation of three expressions used therein, *viz.*, 'trade, commerce and intercourse', 'free' and 'throughout the territory of India'.

(a) TRADE, COMMERCE AND INTERCOURSE

Explaining the word 'commerce' in the Commerce Clause of the U.S. Constitution, MARSHALL, C.J., Stated as early as 1824 in *Gibbons v. Ogden*[44] that

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40. *Ram Chandra Palai v. State of Orissa*, AIR 1956 SC 298 : 1956 SCR 28.
41. *S. Ahmad v. State of Mysore*, AIR 1975 SC 1443 : (1975) 2 SCC 131.
42. *Atiabari Tea Co. Ltd. v. State of Assam*, AIR 1961 SC 232 : 1961 (1) SCR 809.
43. See, *infra*, Ch. XXXIV, for discussion on Directive Principles of State Policy.
44. 5 Wheat, 1 (1824).

"commerce, undoubtedly, is traffic but it is something more; it is intercourse". The framers of the Indian Constitution, instead of leaving the idea of 'intercourse' to be implied by the process of judicial interpretation, expressly incorporated the same in Art. 301.

The words trade and commerce have been broadly interpreted. In most of the cases, the accent has been on the movement aspect. For example, in the *Atiabari* case, the Court emphasized: "Whatever else it (Art. 301) may or may not include, it certainly includes movement of trade which is of the very essence of all trade and is its integral part," and, further, that "primarily it is the movement part of the trade" which Art. 301 has in mind, that "the movement or the transport part of trade must be free," and that "it is the free movement or the transport of goods from one part of the country to the other that is intended to be saved."

Again, in *Madras v. Nataraja Mudaliar*,[45] the Court Stated that "all restrictions which directly and immediately affect the movement of trade are declared by Art. 301 to be ineffective." Nevertheless, cases are not wanting where movement has not been involved but other aspects of trade and commerce have been involved.

The view now appears to be well settled that the sweep of the concept 'trade, commerce and intercourse' is very wide and that the word trade alone, even in its narrow sense, would include all activities in relation to buying and selling, or the interchange or exchange of commodities and that movement from place to place is the very soul of such trading activities. In *Koteswar v. K.R.B. & Co*.,[46] the Supreme Court has held that a power conferred on the State Government to make an order providing for regulating or prohibiting any class of commercial or financial transactions relating to any essential article, clearly permits imposition of restrictions on freedom of trade and commerce and, therefore, its validity has to be assessed with reference to Art. 304(*b*).[47] In this case, a restriction on forward contracts was held to be violative of Art. 301. In *District Collector v. Ibrahim*,[48] the Supreme Court has invalidated under Art. 301 an attempt by a State to create by an administrative order a monopoly to deal in sugar in favour of co-operative societies. The order was issued while the proclamation of emergency was operative and so Art. 19(1)(*g*) could not be invoked.[49] The Court therefore took recourse to Art. 301. Price-control of a commodity may also amount to restriction on trade.[50]

Certain activities may not be regarded as trade, commerce or business although the usual forms and instruments are employed therein, as for example, gambling, and thus an Act restricting betting and gambling is not bad under Art. 301.[51] In this case, the Supreme Court held that the protection afforded by Art. 301 is confined to such activities as may be regarded as lawful trading activities and does not extend to activity which is *res extra commercium* and cannot be said to be trade.

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45. AIR 1969 SC 147 : (1968) 3 SCR 829.
46. AIR 1969 SC 504 : (1969) 1 SCC 255.
47. *Infra*, 1091 *et seq*.
48. AIR 1970 SC 1275 : (1970) 1 SCC 386.
49. *Supra*, Ch XIII, Sec. B; *infra*, Ch. XXXIII, Sec. F; *infra*, Ch. XXIV, Sec. H.
50. *Shree Meenakshi Mills v. Union of India*, AIR 1974 SC 366 : (1974) 1 SCC 468.
51. *State of Bombay v. R.M.D.C.*, AIR 1957 SC 699 : 1957 SCR 874; *supra*, Chs. X and XII.

The question raised in this case was concerned with the validity of a State law regulating lotteries *vis-a-vis* Art. 301. In this case, the Court expressed some sentiments suggesting that unlawful activities opposed to public morality and safety would not be regarded as trade and commerce. But the Court then resiled from this broad proposition saying that the wide proposition that a dealing against morals would not be business, involves the position that the meaning of the expression 'trade or business' would depend upon, and vary with, the general standards of morality accepted at a particular point of time in the country. Such an approach would lead to incoherence in thought and expression. The standards of morality can afford guidance to impose restrictions, but cannot limit the scope of the right.[52]

But again the Court has gone back to the proposition that no one has a right to trade in intoxicating liquors.[53]

Regulation by imposition of levies has recently been held liable to be imposed on the liquor trade more than any other activity since the former is considered inherently noxious, pernicious and res extra commercium. The Court went as far as saying that such levy was "necessary to regulate, by keeping out and excluding persons entering the liquor trade.[54] The Supreme Court has again asserted recently that lotteries contain an element of chance and not skill, and, thus, are of gambling nature. Accordingly, sale of lottery tickets cannot be regarded as 'Trade and Commerce' under Art. 301 so as to claim it as a 'free' trade like any other trade, even when it has the authority of law. "The authorisation under the Act [The Lotteries (Regulation) Act, 1998 enacted by the Centre] is solely for the purpose for the States to earn revenue."[55] The Court has observed:

> "….. we have no hesitation to hold that sale of lottery tickets organised by the State could not be construed to be trade and commerce and even if it could be construed to be so, it cannot be raised to the status of 'trade and commerce' as understood at common parlance or 'trade and commerce" as used under Art. 301."[56]

This means if restrictions are imposed on carrying of lotteries, no breach of Arts. 301 to 304 takes place.

In *Fatehchand v. State of Maharashtra*,[57] the Supreme Court considered the question whether the Maharashtra Debt Relief Act, 1976, was constitutionally valid *vis-a-vis* Art. 301. This depended on the further question whether money-lending to poor villagers which was sought to be prohibited by the Act could be regarded as trade, commerce and intercourse. The Court answered in the negative although it recognised that money-lending amongst the commercial community is integral to trade and is, therefore, trade. In relation to village people, the Court took into consideration the 'anti-social, usurious, unscrupulous' nature of money-lending. The Court thus Stated:

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52. *Krishna Kumar v. State of Jammu & Kashmir*, AIR 1967 SC 1368 : (1967) 3 SCR 50.
53. *P.N. Kaushal v. Union of India*, AIR 1978 SC 1457 : (1978) 3 SCC 558; *Khoday Distilleries Ltd. v. State of Karnataka*, AIR 1996 SC 911 : (1996) 10 SCC 304; *State of Punjab v. Devans Modern Breweries Ltd.*, (2004) 11 SCC 26, at page 83 : (2003) 10 JT 485.
54. *State of Punjab v. Devans Modern Breweries Ltd.*, (2004) 11 SCC 26, at page 105 : (2003) 10 JT 485.
55. *B.R. Enterprises v. State of Uttar Pradesh*, AIR 1999 SC 1867 : (1999) 9 SCC 700.
56. *Ibid.*, at 1903.
57. AIR 1977 SC 1825 : (1977) 2 SCC 670.

> "In short, State action defending the weaker sections from social injustice and all forms of exploitation and raising the standard of living of the people, necessarily imply that economic activities, attired as trade or business or commerce, can be de-recognised as trade or business."

The Court refused to accept the thesis that for purposes of Art. 301, the element of 'movement' was essential. The Court ruled that "dealings of banks and similar institutions having some nexus with trade, actual or potential, may itself be trade or intercourse."

(b) 'FREE'

The Supreme Court emphasized in *Atiabari*[58] that Art. 301 provides that the flow of trade shall run smooth and unhampered by any restriction either at the boundaries of the State, or at any other point inside the States themselves. The majority judgment emphasized that free movement and exchange of goods throughout the territory of India is essential for sustaining the economy and living standards of the country. Art. 301 guaranteeing freedom of trade and commerce and intercourse embodies and enshrines a principle of paramount importance that the economic unity of the country would provide the main sustaining force for the stability and progress of the political and cultural unity of the country.

The Court also ruled that Art. 301 includes freedom from tax laws as well. The Court emphasized that though the power to levy tax is essentially for the existence of the government, its exercise must inevitably be controlled by constitutional provisions and the taxing power is not outside the purview of any constitutional limitations. As the Supreme Court has observed in *India Cement v. State of Andhra Pradesh*:[59] "There can be no dispute that taxation is a deterrent against free flow. As a result of favourable or unfavourable treatment by way of taxation, the course of flow of trade gets regulated either favourably or adversely." Tax laws are not excluded from the scope of Art. 301. A tax which directly and immediately restricts trade will fall within the purview of Art. 301.

The word 'free' in Art. 301 cannot mean absolute freedom or that each and every restriction on trade and commerce is invalid. The Supreme Court has held in *Atiabari* that freedom of trade and commerce guaranteed by Art. 301 is freedom from such restrictions as directly and immediately restrict or impede the free flow or movement of trade.[60] Thus, a restriction which is indirect or inconsequential impediment on trade, commerce, or intercourse is not hit by Art. 301.

The test of direct and immediate restriction has been taken from Australia.[61] Therefore, Art. 301 would not be attracted if a law creates an indirect or inconsequential impediment on trade, commerce and intercourse which may be regarded as remote. In the words of GAJENDRAGADKAR, J., "…. it would be reasonable and proper to hold that restrictions to freedom from which is guaranteed by Art. 301, would be such restrictions as directly and immediately restrict or impede the free flow or movement of trade. Taxes may and do amount to restrictions; but it

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58. AIR 1961 SC 232 : (1961) 1 SCR 809; see, *infra,* note 58.
59. AIR 1988 SC 567 : (1988) 1 SCC 743, at 574.
60. *Atiabari, supra,* footnote 42.
61. *The Bank Nationalization case, supra,* footnote 9.

is only such taxes as directly and immediately restrict trade that would fall within the purview of Art. 301".[62]

The Supreme Court rejected the broad argument that all taxes should be governed by Art. 301 whether or not their impact on trade was mediate or immediate, direct or remote. The Court characterised the argument as "extreme". The Court emphasized that a "rational and workable" test to apply under Art. 301 would be: "Does the impugned restriction operate directly or immediately on trade or its movement?"

One of the arguments raised in *Automobile Transport* was that Arts. 301 and 303 must be read together. Art. 303 uses the words "by virtue of any entry relating to trade and commerce etc." It was argued that these words must be read into Art. 301. This would mean that Art. 301 should be construed as a fetter on the commerce power, *i.e.*, the power given to the Legislature to make laws under entries relating to trade and commerce only. This would mean that Art. 301 would not include taxing powers. The argument was that the freedom guaranteed by Art. 301 would not mean freedom from taxation. The Supreme Court rejected the contention that Arts. 301-305 applied only to legislation in respect of entries relating to trade and commerce and ruled that taxation was included therein.

The State of Karnataka enacted an Act to acquire transport carriages. The Act was challenged on the ground that it impugned on the subject of inter-State trade and commerce as it provided also for acquisition of transport carriages running on inter-State routes. The Supreme Court rejected the contention in *State of Karnataka v. Ranganatha Reddy*[63] saying that the incidental encroachment on the topic of inter-State trade and commerce, even assuming there is some, cannot invalidate the Act. The Supreme Court has emphasized that Art. 301 guarantees freedom from such restrictions as "directly and immediately" restrict or impede free flow of or movement of trade. A rule banned award of leases for quarrying black granite in favour of private parties. The rule was held not violative of Art. 301 as it did not "directly and immediately" restrict or impede "the free flow or movement of trade."[64] A provision would be bad if it imposes a restriction "directly and immediately" on the trade or commerce movement.

Tax laws are not excluded from the scope of Art. 301. A tax which directly and immediately restricts trade would fall within the purview of Art. 301.[65] As was observed by the Supreme Court in *Kalyani Stores v. State of Orissa*,[66] imposition of a duty or tax in every case does not tantamount *per se* to any infringement of Art. 301 of the Constitution. Only such restrictions or impediments which directly or immediately impede free flow of trade, commerce and intercourse fall within the prohibition imposed by Art. 301. A tax in certain cases may directly and immediately restrict or hamper the flow of trade, but every imposition of tax does not do so. Every case must be judged on its own facts and its own setting of time and circumstances.

The State of West Bengal levied a tax on despatches of tea from the State. The Supreme Court declared the tax to be invalid on constituting "a direct and imme-

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62. AIR 1961 SC 232 at 253-54 : (1961) 1 SCR 809.
63. AIR 1978 SC 215 : (1977) 4 SCC 471.
64. *State of Tamil Nadu v. Hind Stone,* AIR 1981 SC 711 : (1981) 2 SCC 205.
65. *Atiabari, supra; Khyerbari, infra.*
66. AIR 1966 SC 1686 : (1966) 1 SCR 865.

diate restriction on flow of trade and commerce in tea throughout the territory of India". The tax thus violated Art. 301 and could have been levied in accordance with the provisions of Art. 304(b). The Court also ruled that there was no entry in Lists II or III under which the State could have levied the tax in question. Further, the Court also ruled that the Centre had taken the tea industry under its control under the Tea Act, 1953. The Centre had also imposed a cess on tea produced in India. Therefore, the impugned State Legislation would be bad as it fell in a covered field.[67]

Commenting on Art. 301, the Supreme Court has observed in a recent case:[68]

> "Suffice it to say that it is only when the intra-State or inter-State movement of the persons or goods are impeded directly and immediately as distinct from creating some indirect or consequential impediment, by any legislative or executive action, infringement of the freedom envisaged by Art. 301 can arise. Without anything more, a tax law, *per se*, may not impair the said freedom. At the same time, it should be Stated that a fiscal measure is not outside the purview of Art. 301 of the Constitution."

From the trend of the case-law it appears that there is a greater readiness on the part of the Courts to characterise an impediment on movement of commerce as 'direct' and so hold it bad under Art. 301,[69] than the one not on movement which is usually held to be indirect or remote and so valid, *e.g.*, octroi,[70] sales tax,[71] purchase tax,[72] etc.

The Supreme Court has ruled that the imposition of sales tax on goods sold within the State cannot be considered as contravening Art. 301.[73] A question was raised whether levy of tax on sale or purchase of tendu leaves in the State of Madhya Pradesh at a higher rate than in the neighbouring States violated Art. 301 as it impeded free trade and commerce in tendu leaves throughout India. The Supreme Court rejected the contention with the remark that "an increase in rate of tax on a particular commodity cannot *per se* be said to impede free trade and commerce in that commodity." A tax may in certain cases directly and immediately restrict or hamper the flow of trade, but every imposition of tax does not do so. Each case has to be judged on its own facts and in its own setting of time and circumstances. In the instant case, no material was placed before the Court to show that the sales tax on tendu leaves had caused any decline in sales or purchase of tendu leaves.

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67. *Automobile Transport Ltd. v. State of Rajasthan,* AIR 1962 SC at 1424.

68. *Amrit Banaspati Co. Ltd. v. Union of India,* AIR 1995 SC 1340, 1343 : (1995) 3 SCC 335.

69. *Khyerbari Tea Co. v. State of Assam,* AIR 1964 SC 925 : (1964) 5 SCR 975.

70. *Transport Corp. of India v. Municipal Corp*., AIR 1963 MP 253; *Orissa Ceramic Industries v. Jharsuguda Municipality,* AIR 1963 Ori 171; *City Municipality v. Mahado,* AIR 1967 AP 363.
Octroi is levied mostly by municipalities and it has been criticised on the ground that it creates trade barriers: *Financial Resources of Urban Local Bodies*, 48 (1965). Rajasthan High Court held octroi invalid in *Gauri Shanker v. Municipal Board,* AIR 1958 Raj 198.
Also see, Ch. XI, Sec. D.

71. *Andhra Sugars Ltd. v. Andhra Pradesh,* AIR 1968 SC 599 : (1968) 1 SCR 705.
Cf. *Derham, supra,* n. 22; also, *G.K. Krishnan v. State of Tamil Nadu,* AIR 1975 SC 583, 590 : (1975) 1 SCC 375.

72. *Walker Anjaria v. State of Rajasthan,* AIR 1969 Raj 162.

73. *Sodhi Transport Co. v. State of Uttar Pradesh,* AIR 1986 SC 1099 : (1986) 2 SCC 486.

But sales tax discriminating between goods of one State from those of another, may affect the free flow of trade and so offend Art. 301.[74] A tax levied by Parliament on inter-State sale would have offended Art. 301 as such a tax, in its essence, encumbers movement of trade or commerce because by its very definition an inter-State sale is one which occasions movement of goods from one State to another. Nevertheless, it was held valid because of Art. 302.[75]

Imposition of luxury tax on charges for accommodation provided in hotel or a lodging house does not infringe Art. 301. The tax in question was neither discriminatory nor it had any direct and immediate effect of impeding the freedom of intercourse. Only such taxes are hit by Art. 301 as have a direct and immediate effect of restricting the free flow of trade, commerce and intercourse. Not all taxes have such an effect. Art. 301 is against the creation of economic barriers and/or pockets which would stand against the free flow of trade, commerce and intercourse.[76]

It is well settled by a catena of decisions that trade in liquor is not a Fundamental Right. It is a privilege of the State. The State parts with this privilege for revenue consideration. The freedom guaranteed by Article 301 is not available to liquor because it is a noxious substance injurious to public health, order and morality. Therefore regulation in the interest of public health and order takes the case out of Art. 301; regulation for the purpose of Arti. 301 is not confined to such regulations which alone will facilitate the trade.[77]

The Supreme Court has emphasized that the freedom envisaged by Art. 301 can be infringed only when the intra-State or inter-State movement of persons or goods are impeded directly and immediately as distinct from creating some indirect or inconsequential impediment, by any legislative or executive action. Without any thing more, a tax law, *per se*, may not impair the freedom of trade. At the same time, it is to be noted that a fiscal measure is not outside the purview of Art. 301. A tax may, in certain cases, directly and immediately impede the movement or flow of trade, but the imposition of a tax does not do so in every case. It depends on the context and circumstances. Measures impeding the freedom of trade, commerce and intercourse may be legislative or executive and may be fiscal or non-fiscal. Freedom may be impeded by impediments on the individuals carrying on trade or business, on the business itself, or on the vehicles, carriers, instruments and labour used in trade and commerce.

Any one aggrieved by infringement of Art. 301 can seek his remedy from the Court against the offending legislative or executive action.

(c) THROUGHOUT THE TERRITORY OF INDIA

The view is definitely held now that Art. 301 applies not only to inter-State, but also to intra-State, trade and commerce as well, *i.e.*, trade within a State.[78]

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74. *Mehtab Majid & Co. v. State of Madras,* AIR 1963 SC 928; see, Sec. G(ii), *infra; A. Hajee Abdul Shukoor & Co. v. State of Madras,* AIR 1964 SC 1729 : (1964) 8 SCR 217.

75. *State of Madras v. Nataraja Mudaliar,* AIR 1969 SC 147 : (1968) 3 SCR 829; *Infra,* for Art. 302, Sec. G(i).

76. *Express Hotels (P.) Ltd. v. State of Gujarat,* AIR 1989 SC 1949 : (1989) 3 SCC 677.

77. *State of Punjab v. Devans Modern Breweries Ltd.,* (2004) 11 SCC 26 : (2003) 10 JT 485.

78. Shah, J., in *State of Madras v. Nataraja Mudaliar,* AIR 1969 SC 147 at 154 : (1968) 3 SCC 829.

This view is also supported by the wordings of Arts. 302 and 304 as is discussed below.[79]

The words "territory of India" in Art. 301 removes all inter-State or intra-State barriers, and bring out the idea that for the purpose of the freedom of trade and commerce, the whole country is one unit. Trade cannot be free throughout India if barriers exist in any part of India, be it inter-State or intra-State.

E. REGULATORY AND COMPENSATORY TAX

It has been Stated that Art. 301 does not confer absolute freedom from taxation in respect of trade, commerce and intercourse. A number of entries in the three Lists, *e.g.*, entries 89 and 92A in List I, entries 52, 54, 56 to 60 in List II and entry 35 in List III, confer taxing powers on the Centre and the States in relation to different aspects of trade, commerce and intercourse.[80] But taxation should not be used to erect barriers, tariff walls or impede free flow of trade and commerce. To reconcile the freedom of trade and commerce and the power of taxation, the Supreme Court has evolved the concept of regulatory and compensatory tax. This means that a regulatory or compensatory tax is not hit by Art. 301.

To smoothen the movement of inter-State trade and commerce, the State has to provide many facilities by way of roads etc. The concept of regulatory and compensatory taxation has been evolved with a view to reconcile the freedom of trade and commerce guaranteed by Art. 301 with the need to tax such trade at least to the extent of making it pay for the facilities provided to it by the State, *e.g.*, a road net-work and other infrastructural facilities.

The concept of regulatory and compensatory taxation has been applied by the Indian Courts to the State taxation under entries 56 and 57 of List II. Measures which impose compensatory taxes, or, are purely regulatory, do not fall with the purview of restrictions contemplated in Art. 301. The reason is that they facilitate, rather than hamper, the flow of trade and commerce.

In *Atiabari*,[81] a tax was levied by the State of Assam on the carriage of tea by road or inland waterways under entry 56, List II.[82] The Supreme Court held the tax bad for "the transport or movement of goods is taxed solely on the basis that the goods are thus carried or transported," and, thus, "directly affects the freedom of trade as contemplated by Art. 301." The purpose and object of the State Act in question was "to collect taxes on goods solely on the ground that they are carried by road or by inland waterways within the area of the State. That being so the restriction placed by the Act on the free movement of the goods is writ large on its face".[83]

The Supreme Court by majority took the view that the freedom guaranteed by Art. 301 would become illusory if the movement, transport, or the carrying of

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79. *State of Bombay v. R.M.D.C.*, AIR 1957 SC 699 : 1957 SCR 874; *Atiabari Tea Co. v. State of Assam, supra; State of Madras v. Nataraja Mudaliar, supra; Koteswar v. K.R.B.Co., supra.*

80. For these various entries, see, *supra*, Ch. X.

81. AIR 1961 SC 232 : (1961) 1 SCR 809.

82. See, *supra*, Ch. XI, Sec. D.

83. AIR 1961 SC at 254.

goods were allowed to be impeded, obstructed or hampered by the taxation without satisfying the requirements of Art. 302 to 304.[84] The Court did not take into consideration the quantum of the tax burden which by no means was excessive. Simply because the tax was levied on 'movement' of goods, from one place to another, it was held to offend Art. 301. The State could have passed the Act in question by following the procedure laid down in Art. 304(b).

The view propounded in *Atiabari* was bound to have great adverse effect upon the financial autonomy of the States. It would have rendered their taxing power under entries 56 and 57, List II, otiose. Accordingly, the matter came to be reconsidered by the Supreme Court in *Automobile Transport v. State of Rajasthan.*[85]

The State of Rajasthan levied a tax on motor vehicles (Rs. 60 on a motor car and Rs. 2,000 on a goods vehicle per year) used within the State in any public place, or kept for use in the State. The validity of the tax was challenged on the ground that it constituted a direct and immediate restriction on the movement of trade and commerce with and within Rajasthan as the tax placed a pecuniary burden on commercial activity, and so was hit by Art. 301.

The Supreme Court ruled by majority that the tax was not hit by Art. 301 as it was a compensatory tax having been levied for use of the roads provided for and maintained by the State. Taking the view that freedom of trade and commerce under Art. 301 should not unduly cripple State autonomy, and that it should be consistent with an orderly society, the Supreme Court now ruled that regulatory measures or compensatory taxes for the use of trading facilities were not hit by Art. 301 as these did not hamper, but rather facilitated, trade, commerce and intercourse. The Court observed that "regulatory measures or measures imposing compensatory taxes for the use of trading facilities do not come within the purview of restrictions contemplated by Art. 301…."

The Court emphasized that without compensatory taxes, the State cannot effectively maintain roads, waterways and airways, and the freedom declared by Art. 301 may then turn out to be an empty one. Similarly, regulations enabling free movement of traffic cannot be described as restrictions impeding the freedom.

A working test to decide whether a tax is compensatory or not would be to enquire whether the trades people are having the use of certain facilities for the better conduct of their business and paying not patently much more than what is required for providing the facilities. A tax does not cease to be compensatory because the precise or specific amount collected is not actually used in providing facilities.[86]

It is not necessary to put the money collected from the tax into a separate fund so long as the facilities for the trades people who pay the tax are provided and the expenses incurred in providing them are borne by the State out of whatever source it may be. Thus, to this extent, the majority view in *Atiabari* was now overruled by *Automobile*.

The concept of compensatory tax evolved in this case was something new as in *Atiabari*, the Court had dismissed the argument that the money realised

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84. See below.
85. AIR 1962 SC 1406 : (1963) 1 SCR 491.
86. *Sharma Transport v. Government of A.P.,* AIR 2002 SC 322 : (2002) 2 SCC 188.

through the tax would be used to improve roads and waterways rather curtly by saying that there were other ways, apart from the tax in question, to raise the money, and that if the said object was intended to be achieved by levying a tax on the carriage of goods, the same could be done only by satisfying Art. 304(*b*). Had the concept of compensatory tax been applied in *Atiabari*, it was possible that the tax might have been held valid.[87] Had the concept of direct restriction evolved in *Atiabari* been applied in *Automobile*, the tax in question would have been held invalid as there is no difference between a tax on carriage of goods as such and one on the instrumentalities used for the carriage of goods and passengers.

Since then the concept of regulatory and compensatory taxes has become established in India. This concept has been applied in several cases[88] and progressively the Courts have liberalised the concept so as to permit State taxation at a higher level. According to *Bolani*,[89] a compensatory tax is levied to raise revenue to meet the expenditure for making roads, maintaining them and for facilitating the movement and regulation of traffic.[90] Taxation on motor vehicles under entry 57, List II,[91] cannot exceed the compensatory nature which must have some nexus with the vehicles using the roads. The Courts have emphasized again and again that under this entry, tax on motor vehicles has to be compensatory in nature for the purpose of raising revenue to meet expenditure for making roads and maintaining them so as to facilitate movement of traffic.[92]

The regulatory and compensatory nature of the tax is that taxing power should be used to impose taxes on motor vehicles which use the roads in the State or are kept for use thereon. Thus, vehicles which do not use the roads (such as tractors, dumpers and rockers), or in any way form part of the flow of traffic on the roads which is required to be regulated cannot be taxed so long as they are working solely within the premises of their owners. Registration of such vehicles under the Motor Vehicles Act is not decisive for the purpose of levy of tax.

The State of Tamil Nadu increased the motor vehicles tax from Rs. 30 to 100 per seat per quarter and this was challenged as being violative of Art. 301. But the Supreme Court upheld the tax in *G.K. Krishnan v. State of Tamil Nadu*.[93] The Court Stated that "a compensatory tax is not a restriction upon the movement part of trade and commerce." The tax should not however go beyond "a proper recompense to the State for the actual use made of the physical facilities provided in the shape of a road".

The State of Gujarat imposed a tax on omnibuses used or kept for use in the State. If the vehicle in respect of which the tax had been paid in advance was not used for some time for reasons "beyond the control of the owner", the tax was to

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87. See S.N. Jain, *supra*, footnote 23.
88. See, *State of Assam v. Labanya Probha*, AIR 1967 SC 1575 : (1967) 3 SCR 611 and other cases mentioned here.
89. *Bolani Iron Ores v. State of Orissa*, AIR 1975 SC 17 : (1974) 2 SCC 777.
90. *Hardev Motor Transport v. State of M.P.*, (2006) 8 SCC 613, at page 621 : AIR 2007 SC 839.
91. See, *supra*, Ch. XI, Sec. D.
92. *Travancore Tea Co. Ltd. v. State of Kerala*, AIR 1980 SC 1547 : (1980) 3 SCC 619; *State of Karnataka v. K. Gopalakrishna Shenoy*, AIR 1987 SC 1911 : (1987) 3 SCC 655; *Kaushikbhai K. Patel v. State of Gujarat*, AIR 1999 Guj 84.
93. *G.K. Krishnan v. State of Tamil Nadu*, AIR 1975 SC 583 : (1975) 1 SCC 375.

be refunded on a proportionate basis. The High Court clarified that the tax on motor vehicles is a compensatory tax levied for use of the road and it is not a tax on ownership or possession of the motor vehicle. This means that the State cannot impose tax on motor vehicles for the purpose of raising revenue. The liability to pay tax cannot exceed the compensatory nature. The tax must have correlation with the use of the road by the vehicle. If a vehicle does not use the road, whatever the reason, it cannot be taxed. If the vehicle is not used, its owner can claim refund of tax paid by him in advance. An omnibus owner who pays the tax in advance is entitled to get refund of the tax for the period during which the vehicle was not put on the road. "The owner need not show that the non-user was on account of reason beyond his control. The insistence on proof of reasons beyond the control of the registered owner….. is beyond the legislative competence of the State".[1]

If a charge is imposed not for the purpose of obtaining a proper contribution to the maintenance and upkeep of the road, but for the purpose of adversely affecting trade or commerce, then it would amount to a restriction on the freedom of trade, commerce and intercourse. A meticulous equivalence between the facilities enjoyed by trade and the levy thereon is not necessary so long as the trade enjoys facilities for the better conduct of their business and they are paying not patently much more "nor is it necessary that there should be a separate fund or express allocation of money for the maintenance of roads to prove the compensatory purpose when such purpose is proved by alternative evidence."

In the instant case, the tax collections amounted to over Rs. 16 crores while the expenditure for the year amounted to Rs. 19.51 crores and this amount did not include the grants to local governments for the repair and maintenance of roads within their jurisdiction. The tax was thus held to be compensatory and hence valid.

An interesting point referred to by the Court in *Krishnan* was that, strictly speaking, a compensatory tax ought to be based on the nature and extent of the use made of the roads, *e.g.*, a mileage or a ton-mileage charge. But the Court did not insist on this approach because of the practical administrative difficulties in imposing a tax at a rate per mile. It is difficult to evolve a formula which will in all cases ensure exact compensation for the use of the road by vehicles having regard to their type, weight and mileage. "Rough approximation, rather than mathematical accuracy, is all that is required."[2] Validity of a tax must be determined not by way of a formula but rather by the result.

The Supreme Court somewhat liberalised the concept of a compensatory tax by upholding a State tax on passengers and goods carried on national highways. Haryana levied a tax on transporters plying motor vehicles between Delhi and Jammu and Kashmir. These vehicles use national highways which are maintained by the Centre, pass through Haryana without picking up or setting down any passenger in the State. The responsibility for constructing and maintaining of national highways rests on the Centre. It was therefore argued by the transporters that the tax levied by the State could hardly be regarded as compensatory. But the Court rejected the contention.[3]

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1. *Kaushikbhai K. Patel v. State of Gujarat, supra*, footnote 92.

2. This is also the approach adopted in the U.S.A.: see, *Howard Marf. v. Bingaman*, (1935) 298 US 407; *Aero Mayflower Transit Co. v. Board of R.R. Commrs.*, (1947) 332 US 497.

3. *International Tourist Corporation v. State of Haryana*, AIR 1981 SC 774 : (1981) 2 SCC 318. Also, *Manmohan Viz. v. State of Haryana*, AIR 1981 SC 1035 : (1981) 2 SCC 334.

The Court ruled that a State incurs considerable expenditure for maintenance of roads and providing facilities for transport of goods and passengers. Even in connection with national highways, a State incurs considerable expenditure not directly by constructing or maintaining them but by facilitating the transport of goods and passengers along with them in various ways such as lighting, traffic control, amenities for passengers, halting places for buses and trucks. That part of a national highway which lies within municipal limits is to be developed and maintained by the State. The Court thus found *sufficient nexus* between the tax and the passengers and goods carried on the national highways to justify the imposition.

However, the Court went on to state that to say that a tax is compensatory and regulatory is not to say that "the measure of the tax should be proportionate to the expenditure incurred on the regulation provided and the services rendered." If the tax were to be proportionate to the expenditure on regulation and service it would not be a tax but fee.[4] While fee is leviable according to the benefits received and the expenditure incurred, in case of a regulatory and compensatory tax it is practically impossible "to identify and measure, with any exactitude, the benefits received and the expenditure incurred and levy the tax according to the benefits received and the expenditure incurred.". What is necessary to uphold a regulatory and compensatory tax is "the existence of a specific, identifiable object behind the levy" and a 'nexus' between the 'subject and the object of the levy.' If that be so, then it is enough; it is not necessary to put the money realised from such a tax into a separate fund or that the levy be proportionate to the expenditure. There can be no bar to an intermingling of the revenue realised from regulatory and compensatory taxes and from other taxes of a general nature. There can be no objection to "more or less expenditure being incurred on the object behind the compensatory and regulatory levy than the realisation from the levy.[5]"

Again, the Supreme Court has asserted in the case noted below:[6] "The concept of 'regulatory and compensatory" tax does not imply mathematical precision of *quid pro quo*." The Court has thus relaxed the connection between the revenue raised from the tax and money spent on the activity.

In *Malwa Bus Service v. State of Punjab*,[7] the Supreme Court has further relaxed the concept of compensatory tax. In this case, in the year 1981, the State of Punjab substantially increased the rate of tax on every stage carriage plying for hire and transport of passengers. The rates adopted were Rs. 500 per seat per year subject to a maximum of Rs. 35,000 per bus irrespective of the distance over which it operated daily. According to the budget figures for 1981-82, the revenue receipts of the government from motor vehicles tax was Rs. 50 crores as against the expenditure of Rs. 34 crores. The tax was challenged on the ground that it

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4. *Supra*, Ch. XI, Sec. H.

5. However in *Jindal Stainless Ltd. (2) v. State of Haryana,* (2006) 7 SCC 241, at page 264 : AIR 2006 SC 2550.

Compensatory tax was described as a sub-class of fees (*infra*).

6. *State of Maharashtra v. Madhukar Balkrishna Badiya,* AIR 1988 SC 2062 : (1988) 4 SCC 290.

7. AIR 1983 SC 634 : (1983) 3 SCC 237.

In *Ambala Bus Syndicate (Pvt.) Ltd. v. State of Punjab*, AIR 1983 P&H 220, the High Court upheld the same tax.

Also see, *B.A. Jayaram v. Union of India,* AIR 1983 SC 1005 : (1984) 1 SCC 168; *K. Mahadevappa v. State of Karnataka,* AIR 1982 Kant 113.

was not compensatory as the government was using it for augmenting its general revenues. But the Supreme Court upheld the tax as compensatory. A charge which is compensatory in nature is not inconsistent with the concept of freedom of trade and commerce.

Describing the principle underlying such a tax, the Court said: "What is essential is that the burden should not disproportionately exceed the cost of the facilities provided by the State." An exact correlation between tax receipts and expenditure incurred on providing facilities for smooth transport service cannot be insisted upon because "such exact correlation is in the very nature of things impossible to attain." There may be in some cases a little excess recovery by way of taxes. "That by itself should not result in the nullification of the law imposing the tax if the extent of such excess is marginal having regard to the total cost involved."

In the instant case, however, the budget expenditure on the roads and bridges did not include the expenditure incurred by the State on other heads connected with road transport, such as, the directorate of transport, transport authorities, provision for bus stands, lighting, traffic police, grants to local authorities. Taking all this expenditure into account, it became clear that a substantial part of the levy on motor vehicles was being spent annually on providing facilities to motor vehicles operators. The Court also pointed out that in later years, the government expenditure on roads and bridges had substantially increased. It also said that the figures of income and expenditure for only one year might present a distorted picture. In this case, cumulative figures of receipts and expenditure for nine years (1973-1982) presented a truer picture. Ultimately, the Court asserted that it has "the ultimate power to decide" whether in truth and substance a tax is compensatory in nature or not.

A further dimension has been given to the concept of compensatory tax by the Supreme Court in *Meenakshi v. State of Karnataka*.[8] Karnataka enhanced tax on passenger vehicles and it was challenged under Art. 301 on the ground that the underlying purpose behind the enhancement was to make good the loss in general revenue suffered as a result of the abolition of octroi and not to collect more revenue for facilitating trade, commerce and intercourse. The Supreme Court rejected the contention arguing that abolition of octroi facilitates movement of goods and passengers and gives a fillip to trade, commerce and intercourse. Abolition of octroi was welcome in trade and business circles. Therefore, the enhanced tax not only 'does not lose the character of being compensatory on the ground that it was enhanced to compensate the loss suffered by the State in its revenues on account of abolition of octroi but as a matter of fact on this very ground it acquires the character of being compensatory." Thus, abolition of octroi was in itself regarded as a facility granted by the State for free flow of inter-State and intra-State trade, commerce and intercourse.

The Bombay Motor Vehicles Tax Act, 1958, levied one time tax at 15 times the annual rate on all motor cycles used or kept for use in the State. Provision was made for refund of the tax in cases where (a) the vehicle was removed outside the State, and (b) the registration of vehicle is cancelled due to scrapping of the vehicle, or for a similar reason. The Supreme Court held the tax to be valid as being "the regulatory and compensatory" in nature. The Court emphasized that

8. AIR 1983 SC 1283 : 1984 Supp SCC 326.

the concept of "regulatory and compensatory" tax "does not imply mathematical precision of *quid pro quo*".[9]

A tax was levied in Gujarat on all omnibuses which were exclusively used or kept for use in the State as contract carriages. The Supreme Court upheld the tax as being compensatory in nature. The Supreme Court has explained in *Maharaja Tourist Service v. State of Gujarat*[10] that to uphold a tax on the basis of its being compensatory, existence of *nexus* between the subject and object of the levy is necessary. However, it is not necessary to show that the whole or a substantial part of the tax collected is utilised. The State is free to determine the rate of tax keeping in view the guideline that the tax is compensatory or regulatory.

The above judicial pronouncements do however show that, in practice, it is very difficult to successfully challenge a levy on motor vehicles. The Supreme Court will invalidate such a levy only when the tax receipts are far in excess of the permissible expenditure. The nature of the tax has also changed. To begin with, the tax was justified on the ground of being a fair recompense for the use of facilities provided by the State. Now anything which smoothens inter-State trade and commerce falls within the compass of 'compensatory' tax. The States have thus secured a good deal of freedom to impose taxation on motor vehicles under entries 56 and 57 of List II.[11]

It may be of interest to know that in Australia, the cost of road-construction is not to be met from a compensatory tax.[12] This is to keep the incidence of taxation on inter-State commerce very low. But the same is permissible in the U.S.A.[13] In India, such capital cost has been included in the concept of a compensatory tax. Also, in India, so far no argument of excessive taxation on trade and commerce has been successful with the Supreme Court.

The Supreme Court progressively liberalized the concept of a "compensatory and regulatory" tax in course of time in *Bhagatram*,[14] the Court has observed "The concept of compensatory nature of tax has been widened and if there is substantial or even some link between the tax and the facilities extended to such dealers, directly, or indirectly the levy cannot be impugned as invalid."

The Supreme Court further liberalized the concept in its pronouncement in *State of Bihar v. Bihar Chamber of Commerce*.[15] The Bihar Legislature levied a tax on entry of goods into a local area for consumption, use or sale therein at a rate, not exceeding 5%, as may be specified by the State Government. The tax fell under Entry 52, List II. The question was whether the tax was hit by Art. 301. As the tax was levied upon the entry of goods into a local area, it was a tax on the movement of goods so the question was raised whether the tax was compensatory in nature. The Supreme Court held the tax valid as being compensatory in nature.

The significant point to note is that nowhere such a nexus between the levy and the provisions of such facilities was mentioned. The State produced no mate-

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9. *State of Maharashtra v. Madhukar Balkrishna Badiya*, AIR 1988 SC 2062 : (1988) 4 SCC 290.
10. AIR 1991 SC 1650 : 1992 Supp (1) SCC 489.
11. *Supra*, Ch. XI, Sec. D.
12. *Hughes & Vale Pty. Ltd. v. New South Wales*, (1955) 93 C LR 127.
13. *Capital Greyhound Lines v. Brice*, 339 US 542 (1950); *Interstate Transit Inc. v. Dick Lindsay*, 283 US 183 (1930).
14. *Bhagatram Rajeev Kumar v. Commr. of Sales Tax*, (1995) 96 STC 645.
15. AIR 1996 SC 2344 : (1996) 9 SCC 136.

rial to establish that the levy was of a compensatory and regulatory in nature. But the Court held this circumstance as being of "no consequence" for the reason that the Court can take "notice" of the fact that the State does provide several facilities to the trade including laying and maintenance of roads, water-ways and markets, etc. The Court observed in this connection:

> "As a matter of fact, since the levy is by the State, we must also look to the facilities provided by the State for ascertaining whether the State has established the compensatory character of the tax. On this basis it must be held that the State has established that the impugned tax is compensatory in nature."[16]

The Court also ruled:

> "It is not and it cannot be stipulated that for the purpose of establishing the compensatory character of the tax it is necessary to establish that every rupee collected on account of the entry tax should be shown to be spent on providing the trading facilities. It is enough if some connection is established between the tax and the trading facilities provided. The connection can be a direct one or an indirect one…"[17]

The Court further maintained that judicial notice can be taken of the fact that the State does provide general facilities to the trade including laying and maintenance of roads, waterways and markets, etc.

On this basis, it became difficult to challenge any tax as being invalid under Art. 301 as the Court can assume that there exists, an "indirect" "nexus" between the tax and the facilities provided by the State to trade and commerce.

The concept of 'compensatory tax' has been borrowed from Australia where it has been evolved to dilute somewhat the rigours of Section 92.[18] Now there is one basic difference between the Indian and the foreign models. In Australia, Section 92 admits of no exception; if a law imposes a restriction on trade, it is just unconstitutional. In this context, the Courts have evolved the test of compensatory tax to loosen the rigours of Section 92. Similarly, in the U.S.A., the States have conceded some power to tax inter-State commerce as against the constitutional protection given to such commerce to help them to raise some funds to maintain roads, etc. Therefore, the concept of compensatory tax has been adopted to make inter-State commerce pay its way.[19]

In India, on the other hand, Art. 301 is not absolute in the sense that Arts. 302 to 304 provide exceptions to it. A State wishing to restrict freedom of trade has only to follow the conditions laid down in Art. 304(b). The question, therefore, arises: when the Constitution itself provides a mechanism to impose restrictions on freedom of trade, is it necessary to adopt other concepts for the same purpose from foreign systems which operate in a very different context? The basic reason for propounding the theory of compensatory taxes appears to be to free the States, to some extent, from the restraints of Art. 304(b). One of these requirements is to have Central consent to their laws restricting trade and commerce.

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16. *Ibid*, at 2349.

17. *Ibid.* See also *State of H.P. v. Yash Pal Garg*, (2003) 9 SCC 92 : (2003) 4 JT 413; *Widia (India) Ltd. v. State of Karnataka*, (2003) 8 SCC 22 : AIR 2003 SC 3095; *Geo Miller & Co. (P) Ltd. v. State of M.P.*, (2004) 5 SCC 209 : AIR 2004 SC 3552; *State of Bihar v. Shree Baidyanath Ayurved Bhawan (P) Ltd.*, (2005) 2 SCC 762 : AIR 2005 SC 932.

18. *Freightlines ad Construction Holding Ltd. v. New South Wales*, (1968) AC 625.

19. *Aero Mayflower Transit Co. v. Board of R.R. Commrs*., 33 2 US 497 (1947).

This has been done on the ground that otherwise State autonomy would be greatly compromised. This is, therefore, a judicial attempt to make the Indian Constitution more federal than what its framers had envisaged it to be.

In the *Krishnan* case,[20] the Court raised the question whether a non-discriminatory tax levied by a State should be regarded as a restriction on trade and commerce because of the feeling that this would curtail State autonomy to levy taxes falling in the State legislative sphere. In the last edition of this book, it was stated:[21]

> "The danger however is that the States may be tempted to impose high taxes on inter-State commerce under regional pressures thus injuring the national economic fabric. The Courts may find it difficult to police the area of State taxation of trade and commerce. The way for a high level of taxation on road transport will be cleared if, in assessing whether a tax is compensatory or not, it relates the revenue accrued to the total expenses on construction and maintenance of roads. Nevertheless, the danger of high taxation on road transport looms large on the horizon. Requirement of Presidential assent would have contained this danger to some extent as the Centre at the time of assenting to State bills could consider whether the road transport could bear the proposed tax or not. It could have also secured a co-ordination in the State taxation by using this power. As it is, the Centre can now achieve any desired results in the area of taxation of road transport not under Art. 304(*b*) but only by enacting a law under entry 35, List III."[22]

This danger turned out to be true as the above cases show. Road transport was heavily taxed in some of the States.

Since the concept of compensatory tax has been judicially evolved as an exception to the provisions of Article 301 and as the parameters of this judicial concept had become blurred, particularly by reason of the decisions in *Bhagatram* and *Bihar Chamber of Commerce*, the Constitution Bench in *Jindal Stainless Ltd. (2) v. State of Haryana*[23] clarified the differences between exercise of taxing and regulatory Power and between "a tax", "a fee" and "a compensatory tax", and held that the test of "some connection" as propounded in Bhagatram case is not applicable to the concept of compensatory tax and accordingly, overruled the judgments of this Court in *Bhagatram Rajeevkumar v. CST and State of Bihar v. Bihar Chamber of Commerce* to that extent. The decision lays down the parameters of the concept of compensatory tax *vis-a-vis* Article 301 as follows:

(i) Compensatory tax is a compulsory contribution levied broadly in proportion to the special benefits derived to defray the costs of regulation or to meet the outlay incurred for some special advantage to trade, commerce and intercourse.[24]

(ii) The quantifiable benefit is represented by the costs incurred in procuring the facility/services, which costs in turn become the basis of reimbursement/ recompense for the provider of the services/facilities…It is a sub-class of "a fee".

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20. *G.K. Krishnan v. State of Tamil Nadu*, AIR 1975 SC 583 : (1975) 1 SCC 375.
21. III ed. (1978) at 361.
22. For entry 35, List III, see, *supra*, Ch. XI, Sec. E.
23. (2006) 7 SCC 241 : AIR 2006 SC 2550.
24. (*Ibid*) at page 268.

(iii) The impugned enactment must facially or patently indicate quantifiable data on the basis of which the compensatory tax is sought to be levied and indicate the benefit which is quantifiable or measurable. If it does not, the burden will be on the State as a service/facility provider to show by placing the material before the Court, that the payment of compensatory tax is reimbursement/ recompense for the quantifiable/measurable benefit provided or to be provided to its payer(s).[25]

F. REGULATORY MEASURES

Regulatory measures are not regarded as violative of the freedom guaranteed by Art. 301. The word 'free' in Art. 301 does not mean freedom from such regulation as is necessary for an orderly society. Regulatory measures do not fall within the purview of the restrictions contemplated by Art. 301. As the Supreme Court has observed: "There is a clear distinction between laws interfering with freedom to carry out the activities constituting trade and laws imposing on those engaged therein rules of proper conduct or other restraints directed to the due and orderly manner of carryingout the activities".[26]

As regards regulatory measures, these may be of diverse nature or of various kinds such as traffic regulations, filing of returns, making of declarations, regulation of hours equipment, weight, size of load, lights, traffic laws, etc. These are some examples of regulatory laws which are not hit by Art. 301.[27] Regulations like rules of traffic facilitate exercise of freedom of trade and commerce whereas restrictions impede that freedom. It is for the Court to decide whether a provision purporting to regulate trade and commerce is in fact regulatory or restrictive of the freedom guaranteed under Art. 301. Similarly, regulation in the interest of public health and order takes the case out of Article 301, and regulation for the purpose of Article 301 is not confined to such regulations alone which will facilitate the trade.[28] Such measures cannot be challenged unless they are shown to be of a colourable nature designed to restrict the free flow of trade, commerce and intercourse.

In the case noted below,[29] the State of Bihar made a law introducing a system of declarations to be made by transporters of goods through the State. This was done to prevent evasion of sales tax. The Supreme Court ruled that the measure was merely of a regulatory nature and does not prohibit or impede transportation

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25. *(Ibid),* at page 268. See also *Hardev Motor Transport v. State of M.P.*, (2006) 8 SCC 613 : AIR 2006 SC 839; Opportunity was given to the States to bring relevant material on record to justify the levy, *Jindal Stainless Ltd. (3) v. State of Haryana,* (2006) 7 SCC 271 : AIR 2006 SC 3127*; K.A. Jose v. R.T.O.,* 2008(1) KLJ 128; *Bharat Earth Movers Ltd. v. The State of Karnataka,* 2007(3) MPHT 69.

26. *G.K. Krishnan v. State of Tamil Nadu,* AIR 1975 SC 583, 587 : (1975) 1 SCC 375.
Also, *Automobile Transport v. State of Rajasthan,* AIR 1962 SC 1406 : (1963) 1 SCR 491; *Assam v. Labanya Probha,* AIR 1967 SC 1575 : (1967) 3 SCR 611; *S. Ahmed v. State of Mysore,* AIR 1975 SC 1443 : (1975) 2 SCC 131. See also *Jindal Stainless Ltd. (2) v. State of Haryana,* (2006) 7 SCC 241 : AIR 2006 SC 2550.

27. *G.K. Krishnan, supra.*

28. *State of Punjab v. Devans Modern Breweries Ltd.,* (2004) 11 SCC 26, at page 103 : (2003) 10 JT 485.

29. *State of Bihar v. Harihar Prasad,* AIR 1989 SC 1119 : (1989) 2 SCC 192.

of goods. On the other hand, it was designed to facilitate the movement of goods throughout the State.[30]

The word "regulation" does not have any fixed or inflexible meaning. It is difficult to define this word as it has no precise meaning. It is a word of broad import, having a broad meaning and is very comprehensive in scope. Every case has to be judged on its own facts and in its own setting of time and circumstances. It may be that in some situations even a 'prohibition' may be regarded as being regulatory in nature and not hit by Art. 301.

A rule banning movement of forest produce within the State between 10 p.m. and sunrise was held to be void under Art. 301 as it was held to be "restrictive" and not "regulatory" in time.[31]

In a number of cases, prohibitions imposed under the Essential Commodities Act, 1955, on the movement of "essential commodities" from the State to any place outside have been validated by being characterised as "regulatory" in nature. In *Ramanathan*,[32] a total ban imposed on the movement of paddy from a few districts in Tamil Nadu to any place outside was held to be "regulatory" in nature and so it was not hit by Art. 301. The Court justified the ban as follows:

> "The placing of such ban on export of food stuffs across the State or from one part of the State to another with a view to prevent outflow of food stuffs from a State which is a surplus State prevents the spiral rise in prices of such foodstuffs by artificial creation of shortage by unscrupulous traders."

In *Bishamber Dayal*,[33] the Supreme Court held that complete prohibition on movement of wheat from one State to another under S. 3(2)(d) of the Essential Commodities Act, 1955, was regulatory in character and did not amount to restriction within Arts. 301 or 304 of the Constitution.[34]

The State of Tamil Nadu declared timber as an "essential" commodity and prohibited its movement from the State to any place outside under the Essential Commodities Act. Characterising the prohibition as regulatory in nature and not restrictive so as to attract Arts. 301 or 304 of the Constitution, the Supreme Court observed:[35]

> "According to us, the expression 'free trade' cannot be interpreted in an unqualified manner. Any prohibition on movement of any article from one State to another has to be examined with reference to the facts and circumstances of that particular case—whether it amounts to regulation only, taking into consideration the local conditions prevailing, the necessity for such prohibition and what public interest is sought to be served by imposition thereof."

Under the Essential Commodities Act, imposition of complete prohibition on the movement of the essential commodities from one State to another in some

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30. Also see, *Sodhi Transport Co. v. State of Uttar Pradesh,* AIR 1986 SC 1099 : (1986) 2 SCC 486.

31. *State of Mysore v. Sanjeeviah,* AIR 1967 SC 1189 : (1967) 2 SCR 361. However it is doubtful whether this decision is still good law. See *State of Tripura v. Sudhir Ranjan Nath,* (1997) 3 SCC 665, at page 677 : AIR 1997 SC 1168.

32. *K. Ramanathan v. State of Tamil Nadu,* AIR 1985 SC 660 : (1985) 2 SCC 116.

33. *Bishaber Dayal Chandra Mohan v. State of Uttar Pradesh,* AIR 1982 SC 33 : (1982) 1 SCC 39.

34. Also see, *Krishan Lal Praveen Kumar v. State of Rajasthan,* AIR 1982 SC 29 : (1981) 4 SCC 550.

35. *State of Tamil Nadu v. Sanjeetha Trading Co.,* AIR 1993 SC 237, 243 : (1993) 1 SCC 236.

circumstances may be treated as regulation and not restriction for "the situations prevailing in any particular State may require complete prohibition on the movement of any essential article or commodity outside the State".

The matter may however be different when a total prohibition is imposed on the movement of goods or articles from one State to another which have not been declared to be essential commodities. In such a case, the State imposing the ban "has to satisfy the Court that in spite of total prohibition it amounts only to regulation of the trade in such articles or even if it was restriction it was reasonable within the meaning of Art. 304(b) of the Constitution and has been imposed by law as required by Art. 304(b)."

Protection of regional interests for political end and not in public interest is not permissible. In *Sanjeetha,*[21] the prohibition was imposed for arranging the supply of timber at fair price and for equitable distribution thereof.

G. EXCEPTIONS TO FREEDOM OF TRADE AND COMMERCE

No freedom can be absolute as absolute freedom of trade, commerce and intercourse may lead to economic confusion and it may degenerate into a self-defeating licentiousness in trade and commerce. The framers of the Constitution realised that under some circumstances freedom of trade and commerce may have to be curbed or curtailed. Therefore, the wide amplitude of the freedom granted by Art. 301 is expressly limited by Arts. 302 to 305. The exceptions to Art. 301 are:

(1) Parliament is given power to regulate trade and commerce in public interest under Art. 302 subject to Art. 303.

(2) The State Legislatures are given power to regulate trade and commerce under Art. 304 subject to Art. 303.

(3) Art. 305 protects existing laws from the operation of Arts. 301 and 303.

(4) Art. 305 also saves nationalization laws from the operation of Art. 301.

The purport of these provisions is two-fold. One, Parliament is entitled by itself to impose restrictions on trade and commerce. Two, the power of the States to do so is restricted. The Centre can prevent a State from imposing a restriction if it is against national interest.

Before, however, Arts. 302 to 304 come into play, the Court has to decide whether the 'restriction' imposed is of a 'regulatory' nature or not. As Stated above, if it is of a regulatory nature, its validity need not be assessed with respect to any of the constitutional provisions contained in Arts. 302 to 304.

(i) PARLIAMENTARY POWER TO REGULATE TRADE AND COMMERCE

(a) ARTICLE 302

Article 302 empowers Parliament to impose by law such restrictions on the freedom of trade, commerce and intercourse between one State and another, or within any part of the territory of India, as may be required in the public interest.

By virtue of Art. 302, Parliament is, notwithstanding the protection conferred by Art. 301, authorised to impose restrictions on the freedom of trade, commerce and intercourse in the public interest. Thus, Art. 302 relaxes the restriction imposed by Art. 301 in favour of Parliament.

The reference in Art. 302 to restriction on the freedom of trade within any part of the territory of India as distinct from freedom of trade between one State and another clearly indicates that the freedom granted by Art. 301 covers both intra-State as well as: inter-State commerce and trade, as Art. 302 is in the nature of an exception to Art. 301.

As the Supreme Court has observed in *Nataraja Mudaliar*: "Art. 301 does not merely protect inter-State trade or operate against inter-State barriers: all trade is protected whether it is inter-State or intra-State by the prohibition imposed by Art. 301". Accordingly, under Art. 302, Parliament can impose restrictions on both inter-State as well as intra-State commerce. Inter-State and intra-State trading activities often have intimate inter-relationship.

A question has been raised whether Parliament should have power to regulate intra-State commerce and whether or not this matter should belong exclusively to the States. The Sarkaria Commission has justified the present position in the following words:[36]

> "The need for empowering Parliament to place restrictions on trade and commerce even within a State is obvious. Ours is a vast country with varying economic potentiality and considerable differences in regard to existing levels of development. The Union's responsibility in respect of certain matters may, therefore, entail regulating trade and commerce even within a State for achieving national objectives. For example, there is the need to protect the interests of the weaker sections of our community like the tribal people etc. Indiscriminate exploitation of natural resources in one State, for example, denudation of forests, may have far reaching implications for other States which may be affected by floods, silting up of reservoirs, etc. Such situations may require imposition of restrictions on trade even within the State. The importance of Parliamentary control over intra-State trade is also significant where centres of production of certain commodities are situated entirely within a State but the centres of consumption are located outside the State."

The requirement of 'public interest' in Art. 302 would not present any serious problem in the way of Parliament regulating trade and commerce because of the strong presumption in favour of Parliamentary legislation being in public interest. The majority judgment in *Atiabari*[37] even suggested that *prima facie* the question of public interest underlying a Parliamentary law imposing restrictions on the freedom of trade 'may not be justiciable'. If this be the correct approach, then Parliament's power to decide what restrictions need be imposed under Art. 302 may be said to be practically unlimited. But the correctness of this view was doubted later by the Supreme Court in *Khyerbari*.[38] In case of Art. 19(1)(g),[39] the concept of public interest is justiciable and there appears to be no reason why Art. 302 should be treated differently. From a practical point of view, however, to hold 'public interest' as justiciable may not mean much for it is rare for a

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36. *Sarkaria Commission Report*, 502 (1988).
37. *Atiabari Tea Co. v. State of Assam*, AIR 1961 SC 232 : (1961) 1 SCR 809; *supra.*
38. *Khyerbari Tea Co. v. State of Assam*¸AIR 1964 SC 925 : (1964) 5 SCR 975; *supra.*
39. *Infra*, Ch. XXIV, Sec. H.

Court to hold that a legislation lacks public interest. A person challenging the law will have to show to the Court why it is not required in the public interest, and this, indeed, is a difficult task except in the rare case where the law is seen on its face to have been passed for a private purpose.[40]

In *Nataraja*[41], the Supreme Court has asserted that "there can be no doubt that exercise of the power to tax may normally be presumed to be in the public interest." It thus means that the presumption can be rebutted by a person challenging a particular tax but the onus is indeed extremely difficult to discharge. In *Nataraja*, the Court said that the presumption was that the imposition of the tax was in public interest. This had not been offset by any contra material in the instant case.

Under the Central Sales Tax Act, an inter-State sale to an unregistered dealer is to be taxed at 10 per cent, or at the rate applicable in the concerned State to intra-State sales whichever is higher. This was challenged under Art. 301. It was argued in *State of Madras v. Nataraja Mudaliar*[42] that the provision in the Central Sales Tax Act authorised the imposition of varying rates of taxation in different States on similar inter-State transactions; this resulted in inequality in tax burden which impeded inter-State trade, commerce and intercourse, and, therefore, it infringed Art. 301. The Supreme Court rejected the argument and observed:

> "The Central Sales tax though levied for and collected in the name of the Central Government is a part of the sales tax levy imposed for the benefit of the States. By leaving it to the States to levy sales tax in respect of a commodity on inter-State transactions no discrimination is practised: and by authorising the State from which the movement of goods commences to levy on transactions of sale Central Sales Tax, at rates prevailing in the State…. no discrimination can be deemed to be practised."

Again, the validity of S. 8(2)(b) of the Central law was challenged which authorises levy of 10% or at the rate prevailing in the State. The challenge was mounted under Arts. 301 and 303.

But the Central Sales Tax Act was justified under Art. 302 under which "the Parliament is, notwithstanding the protection conferred by Art. 301, authorised to impose restrictions on the freedom of trade, commerce or intercourse in the public interest."

The Supreme Court again rejected the challenge in *State of Tamil Nadu v. Sitalakshmi Mills*[43] saying that the provision was made to prevent evasion of tax and so it was "a measure in the public interest," and, therefore, Parliament was competent to make it under Art. 302, even if it imposed restrictions on inter-State commerce. Even if it be assumed that the tax at the higher rate levied by Parliament imposed restrictions on freedom of trade and commerce as Parliament was competent to impose restrictions on that freedom in public interest, and "as the imposition of a tax is normally presumed in the public interest," the provision was not bad as violating Art. 301.

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40. Derham, Problems in Part XIII of the Const., 1 *JILI*, 523, 526.
Also see, *infra*, Sec. G(ii), under Art. 304.
41. *State of Madras v. Nataraja*, AIR 1969 SC 147 : (1968) 3 SCR 829; *supra.*
42. AIR 1969 SC 147 : (1968) 3 SCR 829.
43. AIR 1974 SC 1505, 1509 : (1974) 4 SCC 408.

The Essential Commodities Act has been held to impose reasonable restrictions on the right to carry on trade and commerce as guaranteed by Arts. 19(1)(*g*) and 301.[44] Payment of statutory minimum bonus even when the management has sustained a loss has been held to be reasonable and in public interest within Art. 19(6) and Art. 302. Directive Principles of State Policy are fundamental to the governance of the country and, therefore, what is ordained as State policy cannot be regarded as unreasonable or contrary to public policy. Payment of bonus being in implementation of Arts. 39 and 43 is reasonable.[45]

Article 302 does not speak of 'reasonable' restrictions, yet it has been observed by the Supreme Court in *Prag Ice Mills*[46]: "Although Article 302 does not speak of reasonable restrictions yet it is evident that the restrictions contemplated by it must bear a reasonable nexus with the need to serve public interest."

In several cases,[47] where the constitutional validity of a law imposing restrictions under Art. 302 has been challenged, the Supreme Court has applied the test of reasonableness to uphold the validity of those restrictions. Therefore, the concept of reasonableness has been impliedly introduced into Art. 302. Further, whenever a restriction is challenged, an additional ground raised is that it is inconsistent with Art. 19(1)(*g*).[48] This inevitably brings in the question of reasonableness of the restriction.

Acting under rule 8C of the Tamil Nadu Minor Mineral Concessions Rules, 1959, formulated under the Mines and Mineral (Regulation and Development) Act, 1957, a parliamentary law, the Tamil Nadu Government banned leases for quarrying black granite in favour of private persons. The Central Act and the Concession Rules were challenged under Art. 301 as violating the freedom of trade and commerce. In *State of Tamil Nadu v. Hind Store*,[49] the Supreme Court upheld both. The Act being a regulatory measure for the conservation and discriminate exploitation of the mineral resources of the country and so was outside the purview of Art. 301. Even otherwise, under Art. 302, Parliament is enabled to impose restrictions on freedom of trade and commerce necessary in the public interest and the impugned Act was a law enacted in the public interest. The rule in question was made by the State Government under the said Act and so became its 'part and parcel'. Consequently, said the Court, "statutory rules made pursuant to the power entrusted by Parliament are law made by Parliament within the meaning of Article 302."[50]

Parliament enacted the Municipal Corporation Act, 1957, and empowered the Corporation to levy terminal tax on all goods carried by railway or road in the Union Territory of Delhi from any place outside thereof. The Supreme Court declared the levy valid on two alternative grounds, *viz.*,

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44. *Bishamber Dayal Chandra Mohan v. State of Uttar Pradesh*, *supra*. Similarly a law prohibiting the manufacture of and trade in electrical items without conforming to specified standards is not violative of Articles 302 and 303.See *Sri Balaji Industries v. Union of India (UOI)*, AIR 2007 Kant 118.

45. *Jalan Trading Co. (P) Ltd. v. D.M. Aney*, AIR 1979 SC 233 : (1979) 3 SCC 220.

46. *Prag Rice & Oil Mills v. Union of India*, AIR 1978 SC 1296, 1302 : (1978) 3 SCC 459.

47. *Manick Chand Paul v. Union of India*, AIR 1984 SC 1249 : (1984) 3 SCC 65.

48. For discussion on Art. 19(1)(g), see, *infra*, Ch. XXIV, Sec. H.

49. AIR 1981 SC 711 : (1981) 2 SCC 205.

50. *Ibid*, at 720.

(1) It does not impose any direct and immediate impediment on the inter-State movement of goods and so was not hit by Art. 301 which only hits direct and immediate impediments on intra-State or inter-State movement of goods or persons. "It is true that a tax may in certain cases, directly and immediately impede the movement or flow of trade, but the imposition of a tax does not do so in every case."

(2) Even if the Act "directly and immediately" impedes the movement of the goods, the statutory provision is saved by Art. 302. There is a presumption that the imposition of the tax is in public interest.[51]

The Court has stated that only when the intra-State or inter-State movement of the persons or goods are impeded "directly and immediately as distinct from creating some indirect or inconsequential impediment by any legislative or executive action, infringement of the freedom envisaged by Art. 301 can arise, "without anything more, a tax law, without anything more, may not impair the said freedom. At the same time, it should be Stated that a fiscal measure is not outside the purview of Art. 301 of the Constitution."

(b) ARTICLE 303

Article 303(1), is in terms an exception to Art. 302. It restricts the power of Parliament to impose restrictions on trade and commerce under Art. 302. Art. 303(1) lays down that notwithstanding anything in Art. 302, Parliament shall not pass any law giving any preference to any one State over another, or discriminate between the States *"by virtue of any entry relating to trade and commerce"* in any of the three Lists.[52]

But, then, Art. 303(2) engrafts an exception to the restriction placed by Art. 303(1) on the powers of Parliament. Art. 303(2) says that nothing in Art. 303(1) shall prevent Parliament from making any law, or authorising the giving of, any preference or making, or authorising the making of, any discrimination if it is declared by such law if 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. This exception applies only to Parliament and not to the State Legislatures.

Article 303(1) expressly forbids discrimination relating to trade and commerce. The words in *italics* in Art. 303(1) give rise to difficulties of interpretation. One possible view may be that this expression refers to such entries only as 41 and 42 in List I, 26 and 27 in List II and 33 in List III, and not to other general entries affecting trade and commerce, or to tax entries.[53] A broader view would include within the expression all those entries in the various Lists which "deal with the power to legislate directly or indirectly in respect of activities in the nature of trade and commerce."[54] In the former case, discrimination among the States will not be barred by Parliamentary tax legislation; in the latter case, it will be, as a tax operating on trade and commerce would be covered by Art. 303(1). Obviously, the latter view is the better of the two, for it bars preferential treat-

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51. *Amrit Banaspati Co. Ltd. v. Union of India,* AIR 1995 SC 1340, 1343 : (1995) 3 SCC 335. Also see, *Meera Khandelwal v. State of Madhya Pradesh,* AIR 1997 MP 163.

52. *Supra,* Ch. X.

53. Dissent of Sinha, C.J., in the *Atiabari* case. For tax entries, see, Ch. XI, *supra.*

54. SHAH. J., in the *Atiabari* case, at 262; Subba Rao, J., in the *Automobile* case, at 1434. Also, *infra,* 839, under the State's power to regulate trade and commerce.

ment of a State through any legislation affecting trade and commerce, and many a time the effect of a tax measure may be much more pervasive on the economy than that of a *non-tax* legislation.

In *Automobile*,[55] the Supreme Court did not express any conclusive opinion on this question arguing that the limitation introduced in Art. 303(1) cannot circumscribe the scope of Art. 301. In *State of Madras v. Nataraja Mudaliar*,[56] the Supreme Court again refused to express an opinion on this general question, or even on the limited question whether, for purposes of Art. 303, entries relating to tax on sale of goods (entry 92A, List I or entry 54 of List II) are entries relating to trade and commerce.

The rigours of the limitation imposed on Parliament by Art. 303(1) are relaxed somewhat by Art. 303(2). Under Art. 303(2), Parliament may prefer one State over another, or discriminate between the States, if it is declared by law made by Parliament that it is necessary so to do for the purpose of dealing with a situation arising from scarcity of goods in any part of India. In other words, when Parliament is faced with the task of meeting an emergency created by the scarcity of goods in any particular part of India, Parliament may enact a law making discrimination, or giving preference, in favour of the part thus affected. Such a declaration by Parliament would be conclusive and not justiciable.

The words 'preference to one State over another' and 'discrimination between one State and another' in Art. 303 occur as well in Ss. 51(ii) and 99 of the Australian Constitution. The Australian cases have held that not all differences in treatment amount to preferences and discriminations between the States.[57] The prohibition is attracted when the preference and discrimination is in relation to localities considered as States, or by virtue of their character as States. Further, at times, a law applied uniformly may in effect result in differential treatment of the States owing to economic conditions prevailing therein but this is not prohibited.

Under the Central Sales Tax Act, Parliament has levied a tax on inter-State sales. The tax payable by a dealer is to be assessed by the Sales-tax authorities of each State. The Act does not even fix a uniform rate of tax; in case of a sale to an unregistered dealer, the tax is to be levied at the rate of 7%, or at the rate applicable to the sale of such goods in the State concerned, whichever is higher. It thus happens that the rates of Central sales tax vary from State to State according as the rates of sales tax vary. The tax under the Act is collected by each State and retained by it for its own use.

It was argued in *State of Madras v. Nataraja Mudaliar*[58] that as it hampered trade and commerce by giving preference to one State over another, or by making discrimination between one State and another, Arts. 301 and 303(1) were infringed. The Court rejected the argument holding that an Act enacted for the "purpose of imposing tax which is to be collected and retained by the State" does not amount to a law giving any preference to one State over another, or making

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55. *Automobile Transport v. State of Rajasthan, supra.*

56. AIR 1969 SC 147 : (1968) 3 SCR 829; *supra*.

57. *Elliott v. The Commonwealth*, 54 CLR 657; *Colonial Sugar Refining Co. v. Irving*, 1906 AC 360.

58. Footnote 57, *supra*.

Also, *M.L. Agrawal & Sons v. Asstt. Commrs.*, AIR 1971 All 1; *State of Tamil Nadu v. Sitalakshmi Mills*, AIR 1974 SC 1505 : (1974) 4 SCC 408.

any discrimination between one State and another, merely because of varying rates of tax prevailing in different States. Several reasons were adduced in support of this view.

First, the flow of trade does not necessarily depend upon the rates of sales tax and various other factors also are relevant.

Secondly, referring to the Australian cases,[59] the Court derived the principle applicable in the present case, *viz.*, "where differentiation is based on considerations not dependent upon natural or business factors which operate with more or less force in different localities that the Parliament is prohibited from making a discrimination."[60]

Thirdly, by leaving it to the State from which the movement of goods commences to levy Central sales tax on sale, at rates prevailing in the State, no discrimination can be deemed to be practised. "It is clear that the legislature has contemplated that elasticity of rates consistent with economic forces is clearly intended to be maintained."

The approach of the Court in *Nataraja* appears to have been influenced by the fact that the Central sales tax is to be levied by the State of export; that it is in the interest of such a State to fix such rates of sales tax as may not discourage prospective buyers, and this would discourage the State from imposing an unduly high rate of sales tax. The question of a State of import is, however, specifically covered by Art. 304(a).[61]

Though the scheme of the Central Act was held valid in the *Nataraja* case, nevertheless, there appears to be little doubt that if the Central Act had itself levied differential rates of sales tax (and not left it to the States to fix the rate) then it would have been invalid because of Art. 303. As the Act itself did not do anything like this, and merely left the matter to the States, it could be argued that the Centre was not indulging into any discrimination between State and State. And by equating intra-State and inter-State commerce as to the rates of taxation, even a State could not be said to be discriminating against inter-State commerce.[62]

In *Kannadasan*,[63] the Supreme Court has envisaged the possibility of Parliament imposing different rates of taxation in different States provided there is justification for the same, and that such a distinction does not amount to discrimination and that it is reasonable in the circumstances and has a purpose behind. When the Supreme Court declared invalid the cess imposed on minerals by vari-

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59. *King v. Barger*, 6 CLR 41; *W.R. Moran v. Dy. Fed. Commr. of Tax*, 63 CLR 338.
In Australia, the Centre cannot levy a tax so as to discriminate among the several States. How can this restriction be by-passed in practice is illustrated by the fact-situation in the *Moran* case. The Centre imposed a flour tax and out of the money so collected, payments were made to the wheat-growers. This was done to ensure a reasonable price to wheat-growers. Tasmania being deficit in, and importer of wheat, had no use for the scheme. To compensate the State for the flour tax paid by its residents, the Centre agreed to pay back to Tasmania all that was collected through the tax. The scheme was judicially upheld. It illustrates an effort at achieving not a geographical, but intrinsic, uniformity.

60. *Infra*.

61. AIR 1969 SC at 157.

62. Also see, *Rattan Lal & Co. v. Assessing Authority*, AIR 1970 SC 1742 : 1969 (2) SCR 544; *Associated Tanneries v. Commercial Tax Officer*, AIR 1987 SC 1922 : (1986) 2 SCC 479.

63. *P.Kannadasan v. State of Tamil Nadu*, AIR 1996 SC 2560 : (1996) 5 SCC 670; see, *supra.*

ous States, Parliament enacted a law validating the State levies. This Act was challenged *inter alia* on the ground that Parliament had thus levied the cess at different rates in the various States. But the Supreme Court rejected the contention and upheld the Central Law on the ground of "historical justification". "It is really not a case where the Parliamentary enactment is creating the distinction or different treatment." Differential treatment was already there for long as the States levied the cess at different rates on the same mineral. In such a situation, there was no other way in which Parliament could have validated the State cess.

It has been plausibly argued that Arts. 301 and 303 should be read as independent provisions, and that a law infringing Art. 303 may or may not infringe Art. 301.

Article 302 thus authorises Parliament to mitigate the effect of Art. 301, and Art. 303 does not cut into Art. 302 much. In the end result, Parliament is left with an abundant capacity to regulate trade and commerce and it is more akin to the American Congress in this respect than to the Australian Parliament. Art. 301 is worded on the model of S. 92 of the Australian Constitution, and both provisions restrict Parliament, but then Art. 302, to a very large extent, frees the Indian Parliament from the restraints of Art. 301.

(ii) STATES' POWER TO REGULATE TRADE AND COMMERCE

(a) ARTICLE 303(1)

Like Parliament, Art. 303(1) prohibits the State Legislatures as well from passing 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."[64]

(b) ARTICLE 304

Article 304, consists of two clauses, and each clause operates as a proviso to Arts. 301 and 303.

Article 304 empowers the States, notwithstanding anything in Arts. 301 and 303, to make laws to regulate and restrict the freedom of trade and commerce to some extent. A restriction imposed by a State law on freedom of trade and commerce declared by Art. 301 cannot be valid unless it falls within Art. 304.

(c) ARTICLE 304(A)

Article 304(*a*) imposes no ban, but lifts the ban imposed by Arts. 301 and 303, subject to one condition. Art. 304(a) is thus enabling and prospective. According to Art. 304(a), a State Legislature may by law impose on goods imported from other States any tax to which similar goods manufactured or produced within that State are subject, so, however, as not to discriminate between goods so imported and goods so manufactured or produced.

This provision is limited to one subject-matter only, *viz.*, tax on goods imported in a State from outside. This clause permits the levy on goods from sister States any tax which similar goods manufactured or produced in that State are subject to. In other

64. For these entries, see, Ch. X, *supra.*

words, goods imported from sister States are placed on par with similar goods manufactured or produced inside the State in regard to State taxation within the State allocated field. A State cannot treat imported goods worse than it treats its own goods. This is the demand of the concept of economic unity of India.

A State is debarred from treating goods of other States any the worse than it treats its own goods. Art. 304(a) does not prevent levy of tax on goods; what is prohibited is such levy of tax on goods as would result in discrimination between goods imported from other States and similar goods manufactured or produced within the State. The object is to prevent imported goods being discriminated against by imposing a higher tax thereon than on local goods.

What Art. 304(a) demands is that the rate of taxation on local as well as imported goods must be the same. This is designed to discourage the States from creating "tax barriers" or "fiscal barriers" at the boundaries.[65] Economic unity of India demands that no State levies a discriminatory tax on goods imported from other States: at the same time, imported goods have not been completely immunized from local taxation, for that would have placed the comparable local goods at a disadvantage.

What Art. 304(*a*) thus ensures is that a State may not impose on goods imported from sister-States a tax higher than what is levied on similar goods manufactured or produced in the State itself so that there is no discrimination against inter-State commerce in favour of intra-State commerce. Art. 304(*a*) is satisfied if the rate of tax is the same on goods imported and similar goods locally manufactured.[66] Art. 304(a) thus places goods imported from sister-States on a par with similar goods manufactured or produced inside the State in regard to State taxation within the allocated field.

Madhya Pradesh imposed a sales tax on sale of tobacco sold in the State by an importer. Import of tobacoo by itself was not subject to tax, and if the imported tobacco was not sold in the State, no tax was payable. Still the Supreme Court held that the tax in question directly impeded trade and commerce between Madhya Pradesh and other States. The tax was not saved by Art. 304(*a*) because tobacco manufactured or produced within Madhya Pradesh was not subject to any tax, and so that tax was unconstitutional.[67]

Madras imposed sales tax on tanned hides or skins imported from the other States on their sale price, while the tax on hides or skins tanned within the State was payable on the price of purchase in the raw condition which was substantially lower than their sale price in the tanned form. Similarly, on the hides and skins purchased in the raw form from outside the State, and then tanned within the State, the tax was on the sale price of the tanned hides or skins. But on hides or skins purchased in raw form and tanned within the State, the tax was on the sale price of the raw hides or skins. The result of this provision was to subject tanned hides and skins imported from outside the State to a higher rate of tax than the tax imposed on hides and skins tanned and sold within the State. The Supreme Court declared the rule bad as discriminatory of inter-State trade and

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65. *Shree Mahavir Oil Mills v. State of Jammu & Kashmir*, (1996) II SCC 39.

66. *State of Madras v. Nataraja Mudaliar, supra*; *Rattan Lal & Co. v. Assessing Authority*, AIR 1970 SC 1742 : (1969) 2 SCC 544.
Also, *Laxmi Cotton Traders v. State of Punjab*, AIR 1969 Punj 12.

67. *State of Madhya Pradesh v. Bhailal Bhai*, AIR 1964 SC 1006 : (1964) 6 SCR 261.

commerce as compared to intra-State trade and commerce.[68] The effect of the sales tax on tanned hides or skins imported from the other States was higher than the tax on the local product, and so the tax was discriminatory.

The Court stated that sales tax which has the effect of discriminating between goods of one State and goods of another, may affect the free flow of trade and it will then offend against Art. 301 and will be valid only if it comes within the terms of Art. 304(a). The Court also rejected the contention that Art. 304(*a*) would be attracted only when the import was at the border, *i.e.*, when the goods entered the State on crossing the border of the State. Art. 304(*a*) which allows a State Legislature to impose taxes on goods imported from other States, does not support the contention that the imposition must be at the point of entry only.

The discrimination in the instant case was not visible on the surface, but could be detected only by a study and analysis of the legal provisions and their effect. It is one of those few cases where the utility of constitutional provisions regarding freedom of trade and commerce becomes vivid. The situation dealt with in the instant case proves the wisdom of the constitutional provisions in Articles 301-304. In the absence of such provisions, the States could have raised all kinds of barriers against the free flow and movement of goods across State boundaries.

Raw hides and skins purchased locally in the State were subjected to a sales tax of 3 per cent at the point of last purchase in the State. No tax was to be levied when sold after tanning. As against this, hides and skins imported from other States in raw form and then sold after tanning as dressed hides and skins, were subjected to a tax of 1½% at the point of first sale in the State. This scheme was challenged as discriminatory but the Supreme Court answered in the negative in *Guruviah*.[69] The Court argued that the lower rate of tax on dressed hides and skins would offset the difference between the higher price of dressed hides and skins and the lower price of raw hides and skins. Art. 304(*a*) prevents discrimination against imported goods. The levy of 1½% on dressed hides and skins was not discriminatory as it took into account the higher price of dressed hides and skins.

The Court explained the purport of Art. 304(*a*) as follows:

> "Art. 304(a) does not prevent levy of tax on goods; what it prohibits is such levy of tax on goods as would result in discrimination between goods imported from other States and similar goods manufactured or produced within the State. The object is to prevent discrimination against imported goods by imposing tax on such goods at a rate higher than that borne by local goods since the difference between the two rates would constitute a tariff wall or fiscal barrier and thus impede the free flow of inter State trade and commerce. The question as to when the levy of tax would constitute discrimination would depend upon a variety of factors including rate of tax and the item of goods in respect of the sale of which it is levied."[70]

In *India Cement*,[71] to meet the situation arising from surplus production of cement, the Government of Andhra Pradesh issued a notification reducing the

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68. *A.T.B. Mehtab Majid & Co. v. State of Madras*, AIR 1963 SC 928 : 1963 Supp (2) SCR 435. Also, *A. Hajee Abdul Shakoor & Co. v. State of Madras,* AIR 1964 SC 1729 : (1964) 8 SCR 217.

69. *V. Guruviah Naidu & Sons v. State of Tamil Nadu*, AIR 1977 SC 548 : (1977) 1 SCC 234.

70. *Ibid.*, at 551.

71. *India Cement v. State of Andhra Pradesh*, AIR 1988 SC 567 : (1988) 1 SCC 743.

rate of sales tax on sale of locally produced cement to bulk consumers to 4%. As against this, the sales tax imposed on sale of cement imported from other States was levied at 13.75%. Thus, under the Andhra notification in regard to the local tax, the indigenous cement producers had a benefit of 9.75%. This was designed to benefit local cement manufacturers. The Supreme Court held the notification invalid as it was hit by Art. 304(a). The Court also ruled that the restriction imposed by Art. 301 can be limited, within the constitutional ambit, only by a law made by Parliament or the State Legislature. "No power is vested in the executive authority to act in any manner which affects or hinders the very essence and thesis contained in the scheme of Part XIII (Arts. 301-305) of the Constitution."

The State of Orissa levied a duty on foreign liquor. No such liquor was produced within the State and the whole of it was imported from other States. The Supreme Court ruled in *Kalyani*[72] that if the goods of a particular description were not produced within a State, the power to legislate under Art. 304(*a*) would not be available to it. In the instant case, as no liquor was produced within the State, the State could not use its legislative power under Art. 304(*a*).

But in *State of Kerala v. Abdul Kadir*,[73] the Supreme Court seems to have diluted the impact of *Kalyani*. The State of Kerala imposed a tax on tobacco which was imported into the State from outside. No tobacco was produced within the State. The question was : when no tobacco was produced within the State, could the State tax imported tobacco? Could Art. 304(a) apply in such a situation? The Court now ruled that unless there was infringement of Art. 301, the further question whether it was saved under Art. 304(a) could not arise. Explaining the *Kalyani* ruling, the Court said that ruling was based on the assumption that the enhanced duty on foreign liquor infringed the guarantee under Art. 301 and it could be saved only if it fell within Art. 304(a). This means that before invoking Art. 304(a), the first question to be decided is whether the tax in question directly and immediately hampers free flow of trade and, thus, falls within the prohibition of Art. 301.

In *State of Karnataka v. Hansa Corporation*,[74] the Supreme Court said that a tax levied within the constraints of Art. 304(*a*) would not be violative of Art. 301. "If a State tax law accords identical treatment in the matter of levy and collection of tax on the goods manufactured within the State and identical goods imported from outside the State, Art. 304(a) will be complied with." The effect of Art. 304(a) is to treat imported goods on the same basis as goods manufactured or produced in a State. The State tax was held valid in the instant case under Art. 304(a) as it was levied both on manufactured goods and similar goods imported from outside in a local area.[75]

The appellant purchased iron scrap from local registered dealers as well as from dealers outside the State. He manufactured ingots and sold them mostly within the State. The sale of ingots manufactured from locally purchased was not subjected to any tax, but sale of ingots manufactured out of scrap purchased from

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72. *Kalyani Stores v. State of Orissa*, AIR 1966 SC 1686 : (1966) 1 SCR 865. See also *The Pondicherry Generators Manufacturers' Association v.Union of India,* (2007) 6 MLJ 927.
Also see, *supra*, under entry 51, List II, Ch. XI, Sec. D.

73. AIR 1970 SC 1912 : (1969) 2 SCC 363.

74. AIR 1981 SC 463 : (1980) 4 SCC 697.

75. *Eagle Corporation Pvt. Ltd. v State of Gujarat,* (2007) 1 GLR 213; In Re, *Reliance Industries Limited,* 2008 (I) OLR 620 : Decided On 18-02-2008.

outside the State was subjected to sales tax. Applying the ratio of *Mehtab's* case,[76] the Supreme Court ruled the provision *ultra vires* in the instant case.[77]

The State of Gujarat imposed sales tax at 15% on all electronic goods whether locally manufactured or imported from outside. No distinction was made between the goods produced within the State, or imported from outside. But then, the State reduced the tax to 10% on goods imported from outside and to 1% on locally manufactured goods with a view to give incentive to encourage local manufacturing units. In *Weston Electronics v. State of Gujarat,*[78] the Supreme Court declared that an exception to the mandate declared in Art. 301 and the prohibition contained in Art. 303(1) can be sustained on the basis of Art. 304(a) if the conditions contained therein are fulfilled. In the instant case, the Court declared "the discrimination effected by applying different rates of tax between goods imported into the State of Gujarat and goods manufactured within that State must be struck down."

Accordingly, the Court quashed the notification imposing lower rate of sales tax on locally manufactured electronic goods. While a State Legislature may enact a law imposing tax on goods imported from other States as is levied on similar goods manufactured within that State, the imposition must not be such as to discriminate between goods so imported and goods so manufactured. The Court was of the view that the reduction in the sales tax in the case of goods manufactured locally in order to provide an incentive for encouraging local manufacturing units cannot be sustained if it adversely affects the free flow of inter-State trade and commerce.

In *H. Anraj v. State of Tamil Nadu,*[79] sale of lottery tickets in the State was subjected to a tax of 20% but the sale of Tamil Nadu lottery tickets was exempt. This was challenged in the Supreme Court. The Court ruled that lottery tickets could be treated as "goods" and could thus be subjected to sales tax under entry 54 List II. But, in the instant case, there was discriminatory taxation on "imported goods", *i.e.,* lottery tickets from other States whereas the "indigenous goods" *i.e.,* local lottery tickets were tax exempt. This hampered free flow of trade and commerce and was thus hit by Art. 304(a). It may be noted that in the *RMDC* case,[80] the Supreme Court had ruled that sale in lottery tickets did not amount to trade and commerce. In *Anraj* no reference was made to the ruling in the *RMDC* case.[81] This shows the judicial tendency to seek to uphold, as far as possible, the legislation impugned.

Over the years, the Supreme Court has softened its approach regarding application of Art. 304(a) to State taxation.

A very significant pronouncement has been made by the Supreme Court on the scope of Art. 304(a) in *Video Electronics Pvt. Ltd. v. State of Punjab,*[82] The U.P.

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76. *Supra,* 890, footnote 69.
77. *Andhra Steel Corporation v. Commissioner of Commercial Taxes, Karnataka,* AIR 1990 SC 1912 : 1990 Supp SCC 617.
78. AIR 1988 SC 2038 : (1988) 2 SCC 568.
79. AIR 1986 SC 63 : (1986) 1 SCC 414. Overruled on another point in *Sunrise Associates v. Govt. of NCT of Delhi,* (2006) 5 SCC 603 : AIR 2006 SC 1908.
80. *State of Maharashtra v. RMDC,* AIR 1957 SC 699 : 1957 SCR 874; *supra.*
Also see, *infra,* Ch. XXIV, Sec. H.
81. Also see, *B.R. Enterprises v. State of Uttar Pradesh,* AIR 1999 SC 1867; see, *supra,* Sec. C, under Art. 301.
82. AIR 1990 SC 820 : (1990) 3 SCC 87.

Government issued a notification exempting goods manufactured by a new industrial unit starting production between October 1, 1992, and March 31, 1990, from the levy of sales tax. The notification was challenged under Arts. 304 and 304(a) on the ground that the goods imported into Uttar Pradesh from out of the State thus became subject to a higher tax than goods produced locally.

The Supreme Court rejected the contention. The Court pointed out that the taxes which do not directly or immediately restrict or interfere with trade, commerce and intercourse throughout the territory of India are excluded from the ambit of Art. 301. Sales tax has only an indirect effect on trade and commerce. Normally a tax on sale of goods does not directly impede the free flow of goods.[83] Free flow of trade between the two States does not necessarily or generally depend on the rate of tax alone. Many factors including the cost of goods play an important part in the movement of goods from one State to another. Art. 304 is an exception to Art. 301. The need to take recourse to the exception will arise only if the tax impugned is hit by Arts. 301 and 303. If it is not then Art. 304 does not come into the picture at all.

Commenting on Art. 304(a), the Court has observed that its object is to prevent discrimination against the imported goods at a rate higher than that borne by local goods. "Every differentiation is not discrimination". In the instant cases, the general rate applicable to the goods locally made and on those imported from other States is the same. The question is whether the power to grant exemption to specified class of manufacturers for a limited period on certain conditions is violative of Art. 304(a). Replying in the negative, the Court has observed:

> "In a federal polity, all the States having powers to grant exemption to specified class for limited period, such granting of exemption cannot be held to be contrary to the concept of economic unity."[84]

The Court distinguished *Weston Electronics* by saying that that was a case of differential rates whereas in the instant case, rates of tax are the same for goods imported or produced within the State; what has been done in the instant case is only to give exemption from sales tax for the purpose of ensuring economic development of the State. This shows that the Court satisfied itself by looking at formal equality and ignored the discrimination in effect between imported and locally produced goods. It can hardly be denied that by giving exemption from sales tax, the tax burden was in effect reduced on locally produced goods as burden compared to the imported goods.

The Punjab Government issued a notification levying sales tax on electronic goods at 12% but an electronic manufacturing unit existing in Punjab was to pay only 1% sales tax. The Court upheld this differentiation on the ground that it was necessary to boost the local industry and to stop it from shifting to the neighbouring States.

Commenting on such cases as *Indian Cement*,[85] *Weston Electronics*[86] *and West Bengal Hosiery*,[87] the Court said that there was "naked blanket preference in fa-

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83. See, *Andhra Sugar Ltd. v. State of Andhra Pradesh,* AIR 1968 SC 599 : (1968) 1 SCR 705; *State of Madras v. N.K. Nataraja Mudaliar,* AIR 1969 SC 147 : (1968) 3 SCR 829.
84. AIR 1990 SC at 833.
85. Note 57 on 891.
86. Note 63 on 892.
87. *West Bengal Hosiery Assn. v. State of Bihar,* AIR 1988 SC 1814 : (1988) 4 SCC 134.

vour of locally manufactured goods as against goods coming from outside the State". In these cases exemption was granted without any reason or concession in favour of indigenous manufactured goods which was not available in respect of the goods imported into that State. This therefore amounted to hostile discrimination. But, in the instant case, there was valid, justifiable and rational reason for differentiation.

This judicial approach reduces the efficacy of Art. 304(a). If a State proposes to support local industries, it should take recourse to other expedients, rather than adopt a discriminatory tax regime Art. 304(a) bars discrimination, as such. It does not permit discrimination against imported goods to promote local industry.

(d) ART. 304(B)

Notwithstanding anything in Arts. 301 or 303, Art. 304(*b*) authorises a State Legislature to impose by law such reasonable restrictions on the freedom of trade, commerce or intercourse with or within that State as may be required in public interest. The proviso to Art. 304(b) says that no bill or amendment for this purpose shall be introduced in the State Legislature without the previous sanction of the President.

Though Art. 304(b) requires prior Presidential assent before the bill is introduced in the legislature yet, due to Art. 255, if prior assent is not secured, the infirmity can be cured by subsequent assent of the President after the bill has been passed by the Legislature.[88]

Art. 304(b), therefore, means that if a State Legislature enacts a law which imposes such reasonable restrictions on the freedom of trade, commerce and intercourse with or within that State as may be required in public interest, and if the Bill has been introduced in the State Legislature with the previous sanction of the President, then the State Act would not offend Art. 301. A restriction on the freedom of trade and commerce which is guaranteed by Art. 301 cannot be justified unless the procedure prescribed in Art. 304(b) has been followed.

For application of Art. 304(b) to a tax on trade, three conditions need to be fulfilled:

(a) The Bill has to be introduced or moved in the State Legislature with the prior sanction of the President, or that the Bill has been assented to by the President.

(b) The tax in question constitutes a reasonable restriction.

(c) The tax has been levied in public interest.

The requirement of Presidential assent ensures that a State legislation enacted under pressure of regional economic interests is duly examined by the Centre from the point of view of national economy.[89] This mechanism draws a balance between national and regional economic interests and it makes the Central Government, rather than the Courts, the arbiter of what restrictions the States may be allowed to impose on trade and commerce. This would thus avoid the emergence

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88. *State of Karnataka v. Hansa Corp., supra,* footnote 75 on 1088.

89. Only a letter from the Government of India stating that the Government of India have no objection to the introduction of the levy under Article 304(b) of the Constitution is not the assent or previous sanction of the President. *K. A. Jose v. RTO,* (2008) 1 KLJ 128.

of confusing case-law which has been the feature of the U.S.A. and, to some extent, of Australia.

In *Automobile Transport,*[1] the Supreme Court has compared Art. 304(b) with Art. 302 in the following words :

> "This provision [Art. 304(b)] appears to the State analogue to the Union Parliament's authority defined by Article 302. Leaving aside the pre-requisite of previous Presidential sanction for the validity of State legislation under cl. (b) provided in the proviso thereto, there are two important differences between Article 302 and Article 304(b)... The first is that while the power of Parliament under Article 302 is subject to the prohibition of preferences and discriminations decreed by Article 303(1) unless Parliament makes the declaration contained in Article 303(2), the State's power contained in Art. 304(b) is made expressly free from the prohibition contained in Art. 303(1), because the opening words of Article 304 contain a non-obstante clause both to Article 301 and Article 303. The second difference springs from the fact that while Parliament's power to impose restrictions upon Article 302 upon freedom of commerce in the public interest is not subject to the requirement of reasonableness, the power of the States to impose restrictions on the freedom of commerce in the public interest under Article 304 is subject to the condition that they are reasonable."

In *Atiabari*, a State law imposing a tax on movement of goods in inter-State commerce was held invalid because of lack of Presidential assent. Since Art. 301 covers both inter-State and intra-State commerce, Presidential assent under Art. 304(b) is needed even when a State imposes a restriction only on intra-State commerce, although intra-State commerce falls within the exclusive State legislative domain.

The Supreme Court has ruled that unless the Court first comes to the finding on the available material whether or not there is an infringement of the guarantee under Art. 301, the further question as to whether the statute is saved under Art. 304(b) does not arise.[2]

A State tax levied on dispatches of tea is hit by Art. 301 as it constitutes a direct and immediate restriction on the flow of trade and commerce through the country. As the State Act had not been enacted in accordance with the requirement laid down in Art. 304(b), the Act was held to be invalid.[3]

Article 304 opens with the words "notwithstanding anything in Art. 301 and Art. 303." Art. 304 therefore constitutes an exception not only to Art. 301 but also to Art. 303. Now, Art. 303(1), considered above, prohibits a State (along with Parliament) from discriminating between the States, or from giving preference to one State over another by making laws by virtue of "any entry relating to trade and commerce."[4] Therefore, it appears that a State may discriminate against

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1. AIR 1962 SC 1406 : (1963) 1 SCR 491.
2. *Kalyani Stores v. State of Orissa,* AIR 1966 SC 1686 : (1966) 1 SCR 865.
3. *Buxa Doars Tea Co. v. State of West Bengal,* AIR 1989 SC 2015 : (1989) 3 SCC 211.
4. *Supra*, 889.
Reference has already been made to the conflict of judicial opinion regarding the exact significance of the words 'any entry relating to trade and commerce'. In *Fernandez v. State*, AIR 1955 TC 126, a tax on sale or purchase was held non-challengeable under Art. 303(1) as it fell under entry 54, List II, and not 26, List II. However, in *Bherulal v. Rajasthan*, AIR 1956 Raj 161, it was held that the State could levy an export duty on the export of commodities to other States while exempting from duty commodities meant for local consumption as it was not prohibited by Art. 303.

other States under Art. 304(b) if all the above stated conditions, *viz*., Presidential assent, reasonableness and public interest are fulfilled.[5] But it remains doubtful whether a discriminatory law can be regarded as reasonable or valid *vis-a-vis* Art. 14.[6]

The requirements of Art. 304(*b*) apply to all State laws which impose restrictions on the freedom of trade, commerce and intercourse irrespective of the legislative entries under which they fall.[7] The Supreme Court taking recourse to the words 'Legislature of a State' in Art.304 has Stated that Art. 304 would protect laws made by a State Legislature but not the rules made by the executive government in exercise of delegated legislation.[8] If an Act has already received Presidential assent then an amendment thereof, which does not impose any additional restriction, does not need fresh Presidential assent. The Supreme Court has expressed doubt whether increase in punishment by the amending Act already existing under the original law could really be looked upon as additional restriction upon freedom of trade and commerce.[9]

Tax laws fall within the inhibition of Art. 301. A tax law having a direct and immediate impact on trade and commerce would be barred by Art. 301 unless it satisfies the requirements of Art. 304(*b*).[10] As the Supreme Court explained in *Abdul Kadir,*[11] not all taxes would be tantamount *per se* to an infringement of Art. 301. Some may be. Only such taxes as directly or immediately impede the free flow of trade, commerce or intercourse fall within the prohibition of Art. 301.[12] If so, the question will then be whether such a tax is saved by Art. 304(b). Thus, a tax on entry of goods in a local area infringes Art. 301 as it has a direct and immediate impact on movement of goods.[13] Payment of a luxury tax on storage and vending of tobacco in the shape of a licence-fee as a condition precedent to bringing the goods in the State would constitute a direct impediment on the free flow of goods and therefore on trade and is thus hit by Art. 301. In this case, licensees were required to pay the licence fee in advance before they could bring tobacco within the State.

The State of Rajasthan issued a notification under the Central Sales Tax Act reducing sales tax from 16% to 4% on the inter-State sale of cement. A cement manufacturer in Gujarat which imposed sales tax at 16% challenged the Rajasthan notification on the ground that it created artificial barriers and gave preference in the matter of inter-State trade and commerce to the manufacturers and dealers of cement in Rajasthan over the manufacturers and dealers of cement in Gujarat.

It was established as a fact that the despatches of cement from Rajasthan to Gujarat increased considerably and that the cement produced in Gujarat was placed in a disadvantageous position. The Rajasthan notification had the effect of

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5. See on this, S.N. Jain, *supra*, footnote 23 on 1057 and references cited therein.
6. See, *infra*, Ch. XXI, Sec. B, for discussion on Art. 14.
7. *State of Maharashtra v. Chamarbaugwala*, AIR 1956 Bom 1.
8. *State of Mysore v. H. Sanjeeviah*, AIR 1967 SC 1189 : (1967) 2 SCR 361; *supra*.
9. *Ahmed v. State of Mysore*, AIR 1975 SC 1443 : (1975) 2 SCC 131.
10. *State of Karnataka v. Hansa Corp.*, AIR 1981 SC 463 : (1980) 4 SCC 697.
11. *State of Kerala v. Abdul Kadir*, AIR 1970 SC 1912 : (1969) 2 SCC 363; *Abdul Kadir v. State of Kerala*, AIR 1976 SC 182 : (1976) 3 SCC 219.
12. *State of Bihar v. Bihar Chamber of Commerce*, AIR 1996 SC 2344 : (1996) 9 SCC 136.
13. *Hansa Corp., supra*, footnote 10.

creating a preference to cement manufactured and sold in Rajasthan to the disadvantage of sale of cement manufactured and sold in Gujarat and thus had direct and immediate adverse effect on the free flow of trade. The notification was held to be void. The Supreme Court pointed out that every differentiation is not discrimination but if differentiation is made without a valid reason, *i.e.*, if there are not justifiable and reasonable reasons for differentiation, then that would amount to hostile discrimination.[14] In the instant case, the Court found no valid reason to issue the notification.

This case has now been overruled by the Supreme Court in *Digvijay (II)*.[15] The Court has now ruled that lowering of tax by the State of Rajasthan has had the direct effect of increasing the flow of trade. The mere fact that the local sale of cement in Gujarat has been adversely affected cannot result in the impugned notification being regarded as affecting the free flow of trade and being violative of Art. 301. This provision is concerned with the movement of goods from one State to another and, as far as the present case goes, with the lowering of tax, the movement has increased rather than diminishing.

It was suggested to the Sarkaria Commission that the proviso to Art. 304(b) imposing Central control over State laws may be deleted. The Commission rejected the suggestion with the following remarks:[16]

> "State laws though purporting to regulate intra-State trade may have implications for inter-State trade and commerce. They may impose discriminatory taxes or reasonable restrictions, impeding the freedom of inter-State trade and commerce. If clause (b) of Art. 304 is deleted the commercial and economic unity of the country may be broken up by State laws setting up barriers to free flow of trade and intercourse through parochial or discriminatory use of their powers."

The Commission pointed out that the suggestion arose from the "antiquated and obsolete" theory of federalism which prevailed no longer.[17]

The scheme of Arts. 301 to 304 is well-balanced. "It reconciles the imperative of economic unity of the Nation with interests of State autonomy by carrying out in clauses (a) and (b) of Art. 304, two exceptions in favour of State legislatures to the freedom guaranteed under Art. 301."[18]

(e) JUSTICIABILITY OF REASONABLENESS AND PUBLIC INTEREST

The power of the States to regulate freedom of trade and commerce under Art. 304, when compared with the parallel power of Parliament under Art. 302, would appear to be circumscribed by three additional restrictions, *viz.*, Presidential assent; reasonableness of restrictions; and in the public interest. The requirement of public interest is a common element in both the provisions.

The question arises whether the element of 'public interest' is justiciable. The majority opinion suggested in the *Atiabari* case that the requirement of 'public interest' may be deemed to be non-justiciable as it may be said to be satisfied by

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14. *Shri Digvijay Cement Co. (I) v. State of Rajasthan*, AIR 1997 SC 2609 : (1997) 5 SCC 406.
15. *Shri Digvijay Cement Co. (II) v. State of Rajasthan*, AIR 2000 SC 680 : (2000) 1 SCC 688.
16. *Report, 502.*
17. *Supra*, Ch. XIV.
18. *Report* of the *Sarkaria Commission*, 503.

the Presidential assent. But in *Khyerbari*,[19] the Court called the view as not an expression of a definite opinion that the requirement of "public interest" does not become the subject-matter of adjudication in Court-proceedings when the validity of a law passed under Art. 304(b) is questioned. So, the element of "public interest" appears to be justiciable.[20]

The test of "public interest", however, appears to be the same as in Art. 19(1)(g)[21].

A State may validly impose restrictions under Art. 304(b) which seek to protect public health, safety, morals and property within the State.[22] Thus, a tax on liquor is in public interest as it seeks to protect the health and morals of the people. Similarly, a levy of luxury tax relating to tobacco may be regarded in public interest as consumption of tobacco involves a health hazard.[23] In this case, no tobacco was grown within the State. All tobacco was imported from outside the State. In such a case, taxing imported tobacco could not be regarded as discriminatory between tobacco brought from outside and locally grown tobacco.

Octroi has many defects and there have been constant demands from traders that it be abolished. Therefore, the Supreme Court ruled in *Hansa*[24] that a State tax on entry of goods into local areas for consumption, use or sale therein levied to augment municipal resources which suffered a dent as a result of abolition of octroi was in public interest as it was levied to replace octroi duty which had many obnoxious features. The levy was very modest and was imposed to compensate the loss suffered by abolition of Octroi. The Court went on to observe:

> "…..the taxes generally are imposed for raising public revenue for better governance of the country and for carrying out welfare activities of our welfare State envisaged in the Constitution and, therefore, even if a tax to some extent imposes an economic impediment to the activity taxed, that by itself is not sufficient either to stigmatise the levy as unreasonable or not in public interest."

The question is: does the above Statement mean that every tax is to be presumed to be in public interest, or whether the State should produce some material to show that the tax was levied in public interest.

As regards unreasonableness, the test is the same as is applied to determine reasonableness under Art. 19(6).[25] The test of reasonableness prescribed by Art. 304(b) is justiciable.[26] It may be noted that in Art. 302 the word "reasonable" does not precede the word "restriction" but it does in Art. 304(b).

The levy in *Hansa* was also regarded as not imposing an unreasonable restriction on the freedom of inter-State trade, commerce and intercourse.

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19. AIR 1964 SC 925 : (1964) 5 SCR 975; *supra*.
20. Also see, *Rai Ramakrishna v. State of Bihar*, AIR 1963 SC 1667 : (1964) 1 SCR 897.
21. *Tika Ramji v. State of U.P.*, AIR 1956 SC 676 : 1956 SCR 393; *Vrajlal & Co. v. State of Madhya Pradesh*, AIR 1970 SC 129 : (1969) 2 SCC 248.
Also, *supra*, Sec. C this Chapter; *infra*, Ch XXIV, Sec. H.
22. *Kalyani Stores v. State of Orissa*, AIR 1966 SC 1686 : (1966) 1 SCR 865. Also see, *supra*, 891, footnote 2.
23. *Abdul Kadir v. State of Kerala*, *supra*, 1093, footnote 11.
24. *State of Karnataka v. Hansa Corporation*, *supra*, 1092, footnote 2.
25. *Infra*, Ch. XXIV, Sec. *H: Khyerbari Tea Co*., *supra*; *Abdul Kadir*, *supra*, footnote 11.
26. *Rai Ramkrishna v. State of Bihar*, AIR 1963 SC 1667 : (1964) 1 SCR 897.

Some examples of unreasonable taxes are: discriminatory tax; confiscatory tax; where no machinery is provided for assessment and levy of the tax. If the burden imposed by a tax on trade and commerce is too onerous, then it can be held to be unreasonable.

In the *Khyerbari* case, the Supreme Court held the Assam tax on the movement of tea as being both reasonable and in public interest. In holding the tax in public interest, a factor considered relevant by the Court was that the tax was levied not merely to raise general revenue for the State, which itself was a public purpose, but that it was to be utilised also for keeping the waterways and roads in good condition in the State. The tax was sought to be justified not on the ground of being compensatory, but that it was used to maintain roads and waterways and, therefore, it was in public interest. On a review of the provisions of the Act in question, the Court found the tax to be reasonable as well. The Court even went to the extent of saying that a tax levied by the State must be presumed to be a reasonable restriction inasmuch as taxes are levied to raise money in order to carry on the governmental functions and manifold activities. The Court also suggested that when the President gives his asset it can be presumed that the Central Government has applied its mind and come to the conclusion that the proposed tax constitutes a reasonable restriction and is required to be imposed in public interest. These are however only presumptions.

Reference has already been made to *State of Bihar v. Bihar Chamber of Commerce*.[27] There the Court ruled the entry tax as compensatory. On the assumption that the tax was not compensatory, the Supreme Court also ruled the levy to be valid under Art. 304(5). The Bill had received the prior assent of the President. The levy was held to be reasonable as it imposed a very modest burden on the taxpayer. Also, it would not impede trade and commerce in the taxed services in the State. The levy was held in public interest as the revenue was needed to compensate the loss arising out of the invalidations of a State tax and the revenue arising from the tax was to be spent on public welfare.

The Court rejected the contention in *Khyerbari* that under Art. 304(*b*), a law could not impose a tax with retrospective effect. A statute may be passed under Art. 304(*b*) retrospectively, though the fact that it has retrospective effect may be an element in considering whether it is reasonable or not. In *Atiabari*, the Orissa Taxation (on Goods carried by Road or Inland Waterways) Act was held invalid because of lack of previous sanction of the President as required by Art. 304(*b*). The Orissa Legislature re-enacted the Act in 1968 after securing the previous sanction of the President making it retrospective in operation. The Supreme Court in *Misrilal Jain v. State of Orissa*[28] held the Act valid saying that the laws passed under Art. 304(*b*) need not always be prospective. Power to legislate carries with it the power to legislate retrospectively as well as prospectively. The power to pass a validating Act is essentially subsidiary to the legislative competence to pass a law under an appropriate entry of the relevant list.[29]

The Presidential assent cannot be regarded as affording a tax immunity from such a challenge for it is only one of the three conditions which must be fulfilled for a law to be valid under Art. 304(*b*).

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27. AIR 1996 SC 2344 : (1996) 9 SCC 136; *supra*, footnote 12.
28. AIR 1977 SC 1686 : (1977) 3 SCC 212.
29. Also see, *Rai Ramkrishna v. State of Bihar*, AIR 1963 SC 1667 : (1964) 1 SCR 897.

The guarantee under Art. 301 cannot be taken away by mere executive action. When power of legislation is restricted by Art. 301, but within limits provided by Arts. 302 to 305, it would be impossible to hold that the State by an executive order can do something which it is incompetent to do by legislation.[30]

H. SAVING OF EXISTING LAWS

Article 305 saves the laws enacted before the commencement of the Constitution from the operation of Arts. 301 to 303, except in so far as the President may by order otherwise direct.[31]

The rules made after the commencement of the Constitution under a pre-Constitution Act, cannot be deemed to be 'existing law'. The mere fact that there was authority in the State under a pre-Constitution Act to make rules which may impose restrictions on trade and commerce, but which power was not exercised, will not render the rule made in exercise of the authority after the Constitution an "existing law."[32]

The existing laws are saved until the President by order otherwise directs. Therefore, so long as the President does not act in this matter, burdens on trade and commerce that were existing on the eve of the Constitution would continue to operate. From this it is also clear that the conditions laid down in Art. 304 apply only to those State laws which are enacted after the Constitution.

I. NATIONALIZATION LAWS SAVED

In *Saghir Ahmad v. State of U.P.*,[33] the Supreme Court left undecided the question whether a state monopoly would conflict with Art. 301. As a matter of caution, so that the laws creating state monopolies may not be declared invalid as infringing Art. 301, both retrospectively and prospectively, by reference to Art. 19(6)(*ii*),[34] Art. 305 was amended by the Constitution (Fourth Amendment) Act, 1955.[35]

Article 305 saves from Art. 301, all state monopolistic laws which provide for "the carrying on by the state, or by a corporation owned or controlled by the state, of any trade, business, industry or service, whether to the exclusion, complete or partial, of citizens or otherwise."

The term 'state' includes the Centre as well the States. Thus, a State or the Centre can now run any business on a monopolistic basis without infringing Art. 301.

A law providing for acquisition of banks by the government is protected under Art. 305 and so cannot be challenged under Art. 301.[36]

Article 305 protects a law and not a mere executive action unsupported by law. A monopoly in favour of the State or the Centre cannot be created by a mere

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30. *Dist. Collector v. Ibrahim*, AIR 1970 SC 1275 : (1970) 1 SCC 386.
31. *Bangalore W.C. & S. Mills Co. v. Bangalore Corp.*, AIR 1 962 SC 562 : (1961) 3 SCR 707.
32. *State of Mysore v. H. Sanjeeviah*, AIR 1967 SC 1189 : (1967) 2 SCR 361; *supra*, footnote 8.
33. AIR 1954 SC 728, 742 : (1955) 1 SCR 707.
34. *Infra*, Ch XXIV, Sec. H.
35. *Infra*, Ch. XLII.
36. *R.C. Cooper v. Union of India*, AIR 1970 SC 564 : (1970) 1 SCC 248.

administrative order. Also, Art. 305 does not protect creation of monopoly in favour of a corporation which the state neither owns nor controls.[37]

J. AUTHORITY TO CARRY OUT THE PURPOSES OF ARTICLES 301 TO 304

Problems concerning trade and commerce are more economic in content than legal. A body consisting of economist, businessmen, and lawyers may be able to do a much better job in this area than a Court having merely legal expertise. It is with this idea that Art. 307 has been incorporated in the Constitution.

Article 307 authories Parliament to appoint by law such authority as it considers appropriate for carrying out the purposes of Arts. 301, 302, 303 and 304, and confer on such authority such powers and duties as it thinks necessary.[38]

The origins of the idea contained in Art. 307 can be traced to Ss. 101-104 of the Australian Constitution which contemplate the establishment of an Inter-State Commission "with such powers of adjudication and administration as the Parliament deems necessary for the execution and maintenance within the Commonwealth, of the provisions of this Constitution relating to trade and commerce, and of all laws thereunder." The establishment of such a Commission was directly suggested by the creation of the Inter-State Commerce Commission in the U.S.A. in 1877. A commission was actually established in Australia in 1912 by the Inter-State Commission Act, 1912, but the High Court held that no judicial power could be conferred on it in view of the strict separation of judicial from non-judicial power envisaged by the Australian Constitution. As the Commission could not play any effective role in the absence of judicial power, it was allowed to lapse.[39]

No body as envisaged in Art. 307 has been set up so far. The Sarkaria Commission reporting in 1988 strongly recommended the setting up of an expert body under Art. 307. The Commission argued in favour of such a body as follows:[40]

> "The whole field of freedom of trade, commerce and intercourse bristles with complex questions not only in regard to constitutional aspects but also in respect of the working arrangements on account of impact of legislation of the Union on the powers of the States and the effect of legislation of both the Union and the States on free conduct of trade, commerce and intercourse. Trade, commerce and intercourse cover a multitude of activities. Actions of the Union and State Governments have wide-ranging impact on them. Legislative and executive actions in the field of licensing, tariffs, taxation, marketing regulations, price controls, procurement of essential goods, channelisation of trade, and controls over supply and distribution, all have a direct and immediate bearing on trade and commerce. Innumerable laws and executive orders occupy the field today. This has led to an immensely complex structure. Many issues of conflict of interests arise everyday."

Such a body being free from the pressures of day to day administration would be able to formulate objective views, taking into account the long term perspec-

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37. *Dist. Collector, Hyderabad v. Ibrahim*, AIR 1970 SC 1275 : (1970) 1 SCC 386.
38. Also see, *supra*.
39. *New South Wales v. Commonwealth*, 20 CLR 54 (1915). Collin Howard, *Australian Federal Constitutional Law*, 107-8 (1968).
40. *Report*, 503.

tive, in regard to various intricate problems relating to trade, commerce and intercourse. Being an expert constitutional body it would also inspire confidence among the various States and other interests. Such an expert body would be eminently suited to strike a proper balance between freedom of trade and the need for restrictions in order to foster development with social justice. The ambit of Art. 307 is wide enough to bring all matters relevant to freedom and regulation of trade, commerce and intercourse within the purview of such an authority.

In independent India, inter-State differences have usually arisen on issue of permits for inter-State transport. To sort out these difficulties. Parliament has provided for the creation of an Inter-State Transport Commission under Ss. 63A(1) & (2) of the Motor Vehicles Act, 1939, in pursuance of Art. 307.[41] The Commission consists of a chairman and two members. Its functions are to develop, co-ordinate and regulate the operation of transport vehicles in an inter-State area or route; to prepare schemes for the purpose; to settle disputes and to grant, revoke and suspend permits for an inter-State route or area and to issue directions to the interested State Transport Authorities for the purpose. The Central Government may confer any other functions on the Commission. The Commission can associate with itself a representative of each of the States interested in an area or route.

The Commission thus acts as an instrumentality to promote, and seeks to deal with the problems arising in the way of, co-ordination of the policies of the States in respect of transport on inter-State routes.

It has been decided to introduce the system of national transport permits.[42] Such a permit will enable a public carrier to operate throughout India and will result in better co-ordination of inter-State road transport. Before this, a scheme of zonal permits had been introduced. Gradually, therefore, road transport is being given an inter-State character and is being freed from the restrictions of State boundaries.

The Motor Vehicles Act, 1988, has now abolished the Commission. Under s. 88 of the Act, a State authority has power to issue inter-State transport permits subject to agreement among the States.

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41. Also see, *Road Transport Re-organization Committee Report*, 50 (1959).

42. This scheme has received a set back. The circumstances are narrated by the Supreme Court in *B.A. Jayaram v. Union of India*, AIR 1983 SC 1005 : (1984) 1 SCC 168.