CHAPTER XI

FINANCIAL RELATIONS

SYNOPSIS

A. INTRODUCTORY

Intergovernmental financial relationship in a federation is a vital, or one may say, even a critical matter. It touches the very heart of modern federalism, as the way in which this relationship functions, affects the whole content and working of a federal polity. It is, however, an arduous exercise to create a viable scheme of intergovernmental financial relationship in a federal polity as federalism has its own special and peculiar problems. Finance is an essential pre-requisite of good government.[1]

There being in a federation two sets of governments having functions to discharge, it is essential for the effective working of each government that it be endowed with powers to raise financial resources of its own. This necessitates an apportionment of taxing powers between the Centre and the States. In a federation, therefore, along with division of functions there is also a division of taxing powers between the Central and the State Governments.

But the problems of ordering an inter-governmental financial relationship in a federation does not end with allocating taxing powers between the two levels of government. To enable a government to function effectively, it is not enough that it raises some money to carry on its functions, but what is necessary is that its financial resources match its needs, demands and responsibilities. A balance ought to exist between the financial resources of the government and its allotted responsibilities and functions. If a government is starved of resources necessary

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1. M.P. JAIN, *Taxing Powers in Canada*, 1955 *Vyavahara Nirnaya*, 125-167; M.P. JAIN, *Federal Grants-in-Aid in the U.S.A.*, 1956 *Vyavahara Nirnaya*, 252; M.P. JAIN, *Central-State Fiscal Relationship in India* (1950-1967): A Study of an aspect of Indian Federalism, *Jahrbuch des Offenlichen Rechts Der Gegenwart*, 456-511 [Neue Folge/Band 16 (1968), ed., G. LEIBHOLZ, pub. J.C.B. MOHAIR (Tubingen)]; AUSTIN, THE INDIAN CONSTITUTION, 217-234 (1966); ASOKA CHANDA, FEDERALISM IN INDIA, 134-259.

to carry out its assigned functions, then its powers and autonomy would be no more than a myth.

A sound federal system would, therefore, envisage that financial resources between the Centre and the States are allocated in such a way that there exists a balance, an equilibrium, between the functions and resources at each governmental level. Absence of balance in the function-resource equation at any governmental level is bound to lead to bad government and create tensions, strains and stresses within the federal polity, make it unstable, and *jeopardise* its smooth functioning.

A viable scheme of Centre-State financial relationship is the *sine qua non* for the proper functioning of a federal polity as a whole. But it is a very difficult objective to achieve because of *inter alia* economic disparities among the several States.

It is the universal experience of working of federations that no scheme of allocation of taxing powers results in creating a finance-function balance at each level. It is extremely difficult to create a balance between needs and resources at each level. Some sort of maladjustment always arises.

Usually, the Centre in spite of its own heavy commitments on defence and other services, does emerge with a much stronger financial capacity than the units which always find their resources inadequate to match their responsibilities. Therefore, it becomes necessary to devise expedients to transfer revenue from the Centre to the units so that a balance is created at that level between resources and responsibilities and they become effective instruments of government. A mosaic of intergovernmental financial relations thus arises in a federation.

The Indian Constitution incorporates a very elaborate scheme of Centre-State financial relations. In drawing this scheme, the framers of the Indian Constitution sought to adopt some of the techniques developed in other federations, but at the same time they tried to avoid some of the pitfalls and difficulties which had developed there. The two most conspicuous features of this scheme are: (i) a complete separation of Central-State taxing powers, and (ii) massive transfer of funds from the Centre to the States.

DOUBLE TAXATION

There is no rule against double taxation, as such, *i.e.* the same tax being levied twice on the same tax base either under the same name or under different names. If the legislature so wants it can enact necessary legislation for the purpose.[2] The Constitution has no provision prohibiting double taxation. As the Supreme Court has observed:[3]

> "There is nothing in Art. 265 of the Constitution[4] from which one can spin out the constitutional vice called double taxation."[5]

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2. *Jain Bros v. Union of India*, AIR 1970 SC 778 : (1969) 3 SCC 311.

3. *Avinder Singh v. State of Punjab*, AIR 1979 SC 321 : (1979) 1 SCC 137.

4. See, *supra*, Ch. II, Sec. J(ii)(b).

5. Also see, *Radhakishan Rathi v. Addl. Collector, Durg*, AIR 1995 SC 1540 : (1995) 4 SCC 309; *Municipal Council, Kota v. Delhi Cloth & General Mills Co. Ltd.*, AIR 2001 SC 1060 : (2001) 3 SCC 654. See also *Union of India v. Azadi Bachao Andolan*, (2004) 10 SCC 1 : AIR 2004 SC 1107.

Reference may also be made in this connection to Art. 14 : Ch. XXI, *infra*.

B. ALLOCATION OF TAXING POWERS

Taxing powers are divided between the Centre and the States. The Constitution allots separate legislative heads of taxation to the Centre and the States. The taxes enumerated in the Union List [List I] are leviable by the Centre exclusively while those mentioned in the State List [List II] are leviable by the States exclusively. Not many tax entries are contained in the Concurrent List. This has been done to avoid problems of overlapping and multiple taxation between the Centre and the States.

The scheme of allocation of taxing powers between the Centre and the States is based on the broad principle that the taxes of a local nature have been allotted to the States while taxes which having a tax base extending over more than one State, or which should be levied on a uniform basis throughout the country and not vary from State to State, or which can be collected more conveniently by the Centre rather than the States have been allotted to the Centre. A beneficial result of adopting such a methodology of allocation of taxing powers has been to eliminate all problems of multiple and overlapping taxation which have arisen in an acute form in other federations because of concurrent taxing powers of the Centre and the States. This created manifold complications both for the tax-payer and the tax-collector.[6]

The rules which apply to the interpretation of the non-tax entries apply *mutatis mutandis* to the interpretation of the tax entries as well,[7] *e.g.*, each entry is to be interpreted liberally; in case of any conflict between two or more entries, they should be reconciled; an entry includes all incidental and ancillary matters.

A tax entry, like a non-tax entry, has to be interpreted broadly and liberally.[8] Applying the principle of broad interpretation of the tax entries, it has been held that under a tax-entry, it is possible for a legislature to levy a tax not only prospectively but even retrospectively.[9] The rule of pith and substance is to be applied as and when it becomes necessary to find whether a law is with respect to a given entry. The same rule applies with respect to tax laws. What is relevant is not the consequences of the law on the subject-matter or whether it affects it, but whether, in its pith and substance, it is a law upon the subject-matter in question.[10] If the taxing power is within a particular legislative field, other fields in the legislative lists must be construed to exclude this field so that there is no possibility of legislative trespass.[11]

Since an entry includes all subsidiary or auxiliary matters, therefore, a legislature may make provisions for validating a law declared bad by the courts because of some infirmity, by enacting a validating law by removing the infirmity in question, and making the provisions of the earlier law effective from the date it

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6. See, *infra*, Sec. E.
7. *Supra*, Ch. X, Sec. G.
8. *Supra*, Ch. X, Sec. G(a).
9. *Tata Iron & Steel Co. v. State of Bihar*, AIR 1958 SC 452 : 1958 SCR 1355; *Chhotabhai Jethabhai Patel v. Union of India*, AIR 1962 SC 1006 : 1962 Supp (2) SCR 1; *Jawaharmal v. State of Rajasthan*, AIR 1966 SC 764 : 1966 (1) SCR 890; *Misri Lal Jain v. State of Orissa*, AIR 1977 SC 1686 : (1977) 3 SCC 212.
10. *Supra*, Ch. X, Sec. G(d).
Also see, *Southern Pharm. & Chem. v. State of Kerala,* AIR 1981 SC 1863 : (1981) 4 SCC 391.
11. *Godfrey Phillips India Ltd. v. State of U.P.*, (2005) 2 SCC 515 : AIR 2005 SC 1103.

was passed, and retain the collections made under the original law as being made under the validating law. The most important condition however is that the legislature must have the power to impose the tax, for, if it does not, the action must ever remain ineffective and illegal.[12]

Further, validation of a tax declared illegal may be done only by removing the grounds of illegality or invalidity.[13] However, the Legislature cannot reverse, disobey or disregard a court decision but can remove the basis on which the court decision was based.[14]

While levying a tax, it is competent to the legislature to devise a machinery for effective collection of the tax, to determine procedure for assessing the tax liability and devise and make necessary provisions for preventing its evasion.[15] A provision to seize and confiscate, and levy penalty in respect of, goods carried in a vehicle from one State to another, whether the goods are sold or not, is not incidental to the power to levy sales tax.[16]

When a challenge is made to the levy of a tax, its validity may have to be adjudged mainly by reference to the legislative competence or power to levy the same. In adjudging this issue, the nature and character of the tax has to be determined at the threshold. If the legislature has power to levy the tax, its motive in imposing the same are immaterial and irrelevant. The fact that a wrong reason for exercising the power has been given also would not derogate from the validity of the tax.

When the legislature possesses the competence to levy the tax, the limits of that competence cannot be adjudged further by the form or manner in which that power is exercised. It is not the nomenclature of the tax which is decisive of its nature for the purpose of adjudging its real character or nature to adjudge the competence of the power and authority to legislate or impose the levy. What really has to be seen is the 'pith and substance' or "the real nature and character" of the levy which has to be adjudged with reference to the taxable event and the incidence of the levy.[17] It cannot be argued that a tax under a particular entry must be levied in a particular manner. The legislature is free to adopt such method of levy as it chooses so long as the character of the levy falls within the four corners of the relevant entry.[18]

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12. *M.P. Cement Manufacturers Assocn. v. State of M.P.*, (2004) 2 SCC 249 : (2005) 11 JT 342.

13. *Rai Ram Krishna v. State of Bihar*, AIR 1963 SC 1967; *Shri Prithvi Cotton Mills v. Broach Municipality*, AIR 1970 SC 192 : (1969) 2 SCC 283; *Janapada Sabha, Chhindwara v. C.P. Syndicate Ltd.*, AIR 1971 SC 57 : (1970) 1 SCC 509; *Govt. of Andhra Pradesh v. H.M.T.*, AIR 1975 SC 2037 : (1975) 2 SCC 274; *Hindustan Gum & Chemicals Ltd. v. State of Haryana*, AIR 1985 SC 1683 : (1985) 4 SCC 124; *Central Coal Fields v. State of Orissa*, AIR 1992 SC 1371 : 1992 Supp (3) SCC 133.

14. *Ahmedabad Municipality v. New Shrock Spn. & Weav. Co.*, AIR 1970 SC 1292 : (1970) 2 SCC 280; *State of Tamil Nadu v. M. Rayappa*, AIR 1971 SC 231 : (1971) 3 SCC 1; *Tirath Ram Rajendra Nath v. State of Uttar Pradesh*, AIR 1973 SC 405 : (1973) 3 SCC 585.

15. *Orient Paper Mills v. State of Orissa*, AIR 1961 SC 1438 : (1962) 1 SCR 549 ; *Khyerbari Tea Co. v. State of Assam*, AIR 1964 SC 925 : (1964) 5 SCR 975; *Board of Revenue v. R.S. Jhaver*, AIR 1968 SC 59 : (1968) 1 SCR 148.
Also see, *infra*.

16. *C.P. Officer v. K.P. Abdulla*, AIR 1971 SC 792 : (1970) 3 SCC 355.

17. *Jullunder Rubber Goods Manufacture's Ass. v. Union of India*, AIR 1970 SC 1589 : (1969) 2 SCC 644; *Goodyear India Ltd. v. State of Haryana*, AIR 1990 SC 781 : (1990) 2 SCC 71; *Municipal Council, Kota v. Delhi Cloth & General Mills Co. Ltd.*, AIR 2001 SC 1060.

18. *Goodricke Group Ltd. v. State of West Bengal,*, 1995 Supp. (1) SCC 707; *Twyford Tea Co. v. State of Kerala*,AIR 1970 SC 1133 : (1970) 1 SCC 189.

As the Supreme Court has observed in *Ramakrishna*:[19]

> "The objects to be taxed so long as they happen to be within the legislative competence of the legislature can be taxed by the legislature according to the exigencies of its needs… The quantum of tax levied by the taxing statute, the conditions subject to which it is levied, the manner in which it is sought to be recovered are all matters within the competence of the legislature…"

Once it is found that there is a nexus between the legislative competence and the subject of taxation, the levy will be justified and valid.[20]

The Constitution does not contain any prohibition against double taxation. A subject can be taxed twice over if the legislature evinces a clear intention to do so. There is nothing in Art. 265 from which one can spin out the constitutional vice called double taxation.[21]

VALIDATION OF AN INVALID TAX LEGISLATION

It has been mentioned earlier that if a law is declared invalid by the court, the concerned legislature, provided it has competence to enact the law, can remove the flaws in the law and revalidate it. The same is the position as regards a tax law as well. When a tax law is invalidated by the court, the legislature can, provided it has the competence to enact the law in question, remove the lacunae in the law as pointed by the court and revalidate the tax law. Courts cannot direct the State Legislature to amend the law nor to direct that such amendment shall not be retrospective. It is the exclusive prerogative of the State Legislatures, particularly in tax matters, to enact validation laws which may be directed to apply retrospectively.[22]

But what the legislature cannot do is to declare that in spite of the court verdict to the contrary, the law will be deemed to be valid. This amounts to overriding the court decision by the Legislature, and in consonance with the doctrine of Separation of Powers, a Legislature cannot directly nullify a court decision.

In *Krishna*,[23] the High Court specifically ruled that the power to levy under the law in question could be legal only if the concerned authority collecting the tax rendered services to the tax payers and as no services had been rendered, the collection of the tax was illegal. As this finding was not challenged, it became

19. *Rai Ramakrishna v. State of Bihar*, AIR 1963 SC 1667 : 1964 (1) SCR 897.

20. *State of Karnataka v. Drive-in Enterprises*, AIR 2001 SC 1328.

21. *Avinder Singh v. State of Punajb*, AIR 1979 SC 321 : (1979) 1 SCC 137; *Sri Krishna Das v. Town Area Council, Chirgaon*, AIR 1991 SC 2096 : (1990) 3 SCC 645; *Radhakishan Rathi v. Addl. Collector, Durg*, AIR 1995 SC 1540 : (1995) 4 SCC 309; *Municipal Council, Kota v. D.C.M.*, AIR 2001 SC at 1070.

22. *Municipal Committee, Patiala v. Model Town Residents Assn.*, (2007) 8 SCC 669, at page 683 : AIR 2007 SC 2844; See also *National Agricultural Coop. Marketing Federation of India Ltd. v. Union of India*, (2003) 5 SCC 23 : AIR 2003 SC 1329; *Widia (India) Ltd. State of Karnataka*, (2003) 8 SCC 22 : AIR 2003 SC 3095; *State of H.P. v. Yash Pal Garg*, (2003) 9 SCC 92 : (2003) 4 JT 413; *Mycon Construction Ltd. v. State of Karnataka*, (2003) 9 SCC 583 : AIR 2002 SC 2089; *M.P. Cement Manufacturers' Assn. v. State of M.P.*, (2004) 2 SCC 249 : (2005) 11 JT 342; *Gujarat Ambuja Cements Ltd v. Union of India* (2005) 4 SCC 214 : AIR 2005 SC 3020; *R.C Tobacco (P) Ltd v. Union of India*, (2005) 7 SCC 725 : AIR 2005 SC 4203.

23. *B. Krishna Bhat v. State of Karnataka*, AIR 2001 SC 1885 : (2001) 4 SCC 227; *Gujarat Ambuja Cements v. Union of India* (2005) 4 SCC 214 : AIR 2005 SC 3020.

Also see, *Hindustan Gum & Chemicals Ltd. v. State of Haryana*, AIR 1985 SC 1683 : (1985) 4 SCC 124.

final. Thereafter, the Legislature passed an amending Act declaring that the tax would be deemed to be valid in spite of the verdict of the High Court. The Supreme Court ruled that the State Legislature could do no such thing. The Legislature had not cured the lacuna pointed out by the High Court. The Legislature had no power to reverse the ruling of the High Court. When the Legislature seeks to validate a tax law declared invalid by a court, the Legislature must remove the cause for its ineffectiveness or invalidity before its validation can take place effectively. It is not sufficient to declare that the court declaration would not be binding. A Legislature has no power to directly overrule a judicial decision.

C. CENTRAL TAXES

Entries 1 to 81 in this List confer general legislative powers on Parliament, while entries 82 to 92B enumerate the taxes which, Parliament is entitled to levy exclusively.

The tax entries mentioned in the Union List are as follows:

82. Taxes on income other than agricultural income

The power to levy income-tax is divided between the Centre and the States. The Centre can levy a tax on non-agricultural income, while tax on agricultural income is assigned to the States (entry 46, List II). Under Article 366(1), the expression "agricultural income", for the purpose of abovementioned entries, means agricultural income as defined for the purposes in enactments relating to Indian income tax. This mechanism has been devised to avoid a conflict with the legislative power of States in respect of agricultural income.[24] Income tax enactments in force from time to time can define the term "agricultural income" in any particular manner and that would be the meaning not only for the tax enactments but also for the Constitution. For example, in the case of income derived from sale of tea grown and manufactured by the seller, 40% thereof would be liable to income tax and only the balance 60% would be deemed to be "agricultural income" which could be subjected to agricultural income tax by the State Legislature.[25]

In accordance with the judicial policy of interpreting the legislative entries broadly and liberally[26], the courts have interpreted the term "income" in entry 82 in a very liberal manner. Thus, the Supreme Court has ruled that the word 'income' in that entry is of elastic import as it is used in a wide and comprehensive connotation.

The word 'income' embraces within it every kind of receipt or gain either of a capital nature or of a revenue nature. The Court has insisted that in understanding the amplitude and scope of the expression 'income' in this entry, any meaning which fails to accord with the plenitude of the concept of 'income' in all its width and comprehensiveness should be avoided. Accordingly, the Court has ruled that a tax on gross receipts of certain categories of hotels does not fall outside entry

24. *CIT v. Willamson Financial Services*, (2008) 2 SCC 202, at page 213 : (2007) 13 JT 581.
25. *Commissioner of Income Tax v. Willamson Financial Services*, (2008) 2 SCC 202 : (2007) 13 JT 581.
26. See, *supra*, Ch. X, Sec. G(a).

82, List I, and the Hotel Receipts Tax Act, 1980, has been held as not falling out of the entry and hence valid.[27]

The term, 'income' has been held to embrace any profit or gain which is actually received and, therefore, a tax on capital gains,[28] or pension,[29] is permissible under this entry. Parliament can tax what can rationally be considered as 'income' and thus a loan advanced to a shareholder of a company can be treated as his income and taxed as such.[30] The entry authorises not only the imposition of a tax but also the enactment of a law preventing evasion of the tax imposed.[31] A tax on income includes an excess profits tax.[32] The word 'income' in this entry is to be interpreted in its widest amplitude.

The computation of income of the assessee from any property (even in case of self-occupied house) in the income for purposes of income-tax is valid under this entry and it does not fall under entry 49, List II. The tax is on income from house property and not on property.[33] In case of self-occupied property, income is computed in an artificial way. See also entry 60, List II.[34]

In accordance with the judicial view that the entries are not 'powers' but 'fields of legislation', it has been held that entry 82 does not only authorise the imposition of income-tax but also authorises making of a law to present evasion of the tax imposed. If it were not so, then the power to impose income-tax could be nullified by tax payers adopting ingenious contrivances to evade the tax.[35] Each entry extends to all ancillary and sundry matters which can fairly and reasonably be said to be comprehended in it. Thus, the power to levy surcharge on income tax is traceable to this entry.[36]

The Income Tax Act, 1961, is a law made under this entry.

83. Duties of customs including export duties

The Centre can levy duties on imports into, and exports from, the country. Storage or stocking of imported goods is also covered by this Entry.[37]

84. Duties of excise on tobacco and other goods manufactured or produced in India except—(a) alcoholic liquors for human consumption; (b) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry

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27. *The Elel Hotels & Investments Ltd. v. Union of India*, AIR 1990 SC 1664, 1668 : (1989) 3 SCC 698.

28. *Navinchandra Mafatlal v. Commr. of Income-tax*, AIR 1955 SC 58 : (1955) 1 SCR 829.

29. *Rajagopalachari v. Corp. of Madras*, AIR 1964 SC 1172 : (1964) 6 SCR 962.

30. *Navnit Lal v. I.T. Asst. Commr.*, AIR 1965 SC 1375 : (1965) 1 SCR 909.

31. *Baldeo Singh v. I.T.O.,* AIR 1961 SC 736; *Balaji v. I.T.O.,* AIR 1962 SC 123 : (1962) 2 SCR 983.

32. Art. 366(29).

33. *Bhagwan Dass Jain v. Union of India*, AIR 1981 SC 907 : (1981) 2 SCC 135; *Chelmsford Club v. C.I.T.*, (2000) 3 SCC 214 : AIR 2000 SC 1092.

34. *Infra*, Sec. D.

35. *Sardar Baldeo Singh v. CIT,* AIR 1961 SC 736 : (1961) 1 SCR 482; *Balaji v. Income-tax Officer, Special Investigation Circle, Akola,* AIR 1962 SC 123 : 1962 (2) SCR 983; *Union of India v. A. Sanyasi Rao,* AIR 1996 SC 1219 : (1996) 3 SCC 465; *Union of India v. M.V. Valliappan,* AIR 1999 SC 2526 : (1999) 6 SCC 259.

36. *CIT v. Suresh N. Gupta*, (2008) 4 SCC 362 : AIR 2008 SC 572.

37. *Godfrey Philips India Ltd v. State of U.P.*, (2005) 2 SCC 515 at page 546 : AIR 2005 SC 1103.

The term 'goods' in this entry refers to such goods which are capable of being sold to consumers.[38]

The area of excise duties is divided between the Centre and the States. The items excluded from the Central sphere under this entry fall within the State sphere under entry 51, List II.[39] Under this entry, all duties of excise save the ones excepted specifically, are generally within the taxing power of the Centre.

The term 'duties of excise' is of a very general and flexible import and is often used to cover a variety of taxes on commodities. Because the term 'excise' may cover a 'sales tax' also, a question arose as to how to reconcile the entry 'duties of excise' in the Central List with the entry 'sales tax' in the State List.[40]

In *In re the Central Provinces and Berar Act No. XIV of 1938,*[41] a provincial tax on retail sales of petrol and lubricants was challenged by the Centre on the ground that it was a 'duty of excise' and not a 'sales tax'. The Federal Court negativing the contention held the tax valid. It pointed out that the primary and fundamental meaning of excise is that of a tax on articles produced or manufactured in the country. Taken alone by itself, the Central power to levy excise duties could have been interpreted broadly so as to include sales-tax, but here the question was of reconciling the two entries which should be interpreted together and the language of one modified by that of the other. The general power should be interpreted restrictively so that effect might be given to the narrower power of the Provinces.[42] The term 'excise' has thus come to be restricted to a duty on manufacture or production of goods.

The definition of the word 'manufacture' in this entry has raised some controversy. The taxable event under excise law is 'manufacture' of goods. The Supreme Court has defined 'manufacture' as follows: "The moment there is transformation into a new commodity commercially known as a distinct and separate commodity having its own character, use and name, whether be it the result of one process or several processes, 'manufacture' takes place and liability to excise duty is attracted.

Conversion of raw ground-nut and til oil into refined oil after deodorisation is manufacture. 'Manufacture' is not equal to 'processing'. 'Manufacture' means "bringing into existence a new substance" and does not mean merely "to produce some change in a substance", however minor in consequence the change may be.[43] The "test of irreversibility" is also an important criterion to ascertain as to when a given process amounts to manufacture. So when sandal-wood oil produced from red oil can be reconverted into red oil there is no manufacture.[44]

In *Empire Industries Ltd. v. Union of India,*[45] the Supreme Court has ruled that bleaching, dyeing, printing and finishing of man-made/cotton fabrics constitute

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38. *Union Carbide India Ltd. v. Union of India,* AIR 1986 SC 1097 : (1986) 2 SCC 547.

39. See, Sec. D, *infra.*

40. *Infra,* Sec. D.

41. AIR 1939 FC 1.

42. *Supra,* Ch. X, Sec. D.

43. *Union of India v. Delhi Cloth & General Mills,* AIR 1963 SC 791 : 1963 Supp (1) SCR 586. Also see, *Union of India v. Ramlal Mansukhrai,* AIR 1971 SC 2333 : (1970) 2 SCC 472.

44. *Punjab Aromatics v. State of Kerala,* (2008) 11 SCC 482.

45. AIR 1986 SC 662. Also see*, Ujagar Prints v. Union of India,* AIR 1987 SC 874 : AIR 1989 SC 516.

manufacture as commercially a different article is produced after these processes from the cloth which undergoes these processes. Human skills and materials are used in the processing of fabrics.

Excise duty is levied on the manufacture or production of goods, though for the sake of convenience, it may be collected at the stage of removal of goods from the factory. If no excise duty was leviable at the time of manufacture of goods, it cannot be levied at the stage of removal of the said goods.[46]

A tax on the first sales of his products by a manufacturer is a sales tax and not an excise, because it is a tax levied on him *qua* seller and not *qua* manufacturer. There is no bar in a manufacturer or producer being required to pay excise duty to the Centre and sales tax to a State in respect of sale of goods produced by him.[47] An excise can be collected at any stage. It may be collected even from the consumers of goods so long as it remains a tax on its manufacture.[48]

A duty on coal raised at the collieries is a duty of excise. Though coal is a natural product, yet the operations required to bring it up to the surface, and make it usable, are so elaborate and expensive that coal may be regarded as covered by entry 84, as goods produced.[49] 'Mritsanjibini", an ayurvedic medicine, is a medicinal preparation containing alcohol and falls under this entry.[50]

A duty of excise can be imposed on production of rubber.[51] A tax on purchase of raw materials for manufacture of some commodity is not an excise but sales tax as the taxable event is not production but sale.[52]

The Central Excises and Salt Act, 1944, introduces a licensing system for production, manufacture, wholesale purchase or sale of any excisable goods. These provisions were challenged as going beyond entry 84 of List I, and falling under entries 26 and 27 of List II as regulating trade and commerce. The Supreme Court held that the Act 'is a fiscal measure to levy and realise duty on tobacco" and that Parliament's "powers of taxation should not be restricted so as to exclude the raising of revenue by imposing licence fees." The Act thus fell under entry 84 and trenching upon the State field would not affect its validity because of the rule of pith and substance.[53]

Being a tax on goods manufactured or produced, ordinarily excise is computed on the manufacturer's price, *i.e.*, manufacturing cost plus manufacturer's profit. This was the basis adopted until 1973 in India. But in 1973, the Central Excise and Salt Act was amended so as to expand the concept of assessable value of excisable goods by including therein the post-manufacturing expenses as well, such as, expenses incurred on advertisements, publicity, sales organisation, storage, packing, to determine the tax liability of the manufacturer. The Supreme Court has ruled in favour of the broader concept. Thus the Court has augmented

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46. *CCE v. Vazier Sultan Tobacco Co. Ltd.*, (1996) 3 SCC 434 : AIR 1996 SC 3025.
47. *Governor-General-in-Council v. State of Madras*, AIR 1945 PC 98.
48. *J.R.G. Mfg. Ass. v. Union of India*, AIR 1970 SC 1589 : (1969) 2 SCC 644.
49. *Aluminium Corp. v. Coal Board*, AIR 1959 Cal. 222.
50. *M.B.S. Oushadhalaya v. Union of India*, AIR 1963 SC 622 : 1963 (3) SCR 957.
51. *Rubber Chappal Mfg. Ass. v. Union of India*, AIR 1964 Punj. 465.
52. *N.R. Mills v. State of Punjab*, AIR 1963 Punj. 549.
53. *Chaturbhai v. Union of India*, AIR 1960 SC 424 : (1960) 2 SCR 362; also, *Abdul Kadir v. State of Kerala*, AIR 1962 SC 922 : 1962 Supp (2) SCR 741.
See, *supra*, Ch. X, Sec. G(d).

the tax resources of the Centre which can now collect much larger amount of excise revenue.[54] Thus, it was held that the levy of excise duty on the production of electricity falls within the phrase "other goods manufactured" in Entry 84 of List I and within the exclusive jurisdiction of Parliament, the State having the competence only to levy tax only on the sale and consumption of electricity.[55]

The term 'excise' has been interpreted very broadly in Australia and the U.S.A. In the U.S.A., the Central Government's power to levy direct taxes is very much restricted and, therefore, it was enabled to levy succession tax, corporate income-tax and even general income-tax, by characterising these taxes as 'excise'[56]. In Australia, the States are debarred from levying 'excises'. By interpreting 'excise' broadly as a tax on goods, many State taxes on sale, use, consumption or production have been characterised as 'excises' and thus placed beyond the State purview.[57]

In Canada, the problem is entirely different. There the Provinces are debarred from levying 'indirect' taxes. The Provinces, however, in order to augment their resources started levying taxes on consumption, the most important of which was the sales tax. The Privy Council held that if a tax was paid by the person on whom it was levied and if its incidence was not passed on to someone else, it would not be an 'indirect' tax. Thus, it became possible for the Provinces to levy sales tax by placing the tax liability on the purchaser and making the seller a tax collector.[58]

In India, on the other hand, courts have refused to interpret entry 84 in the Light of these foreign precedents and have restricted the concept of 'excise' to a tax on production and manufacture.

As far as the levy of excise duties on liquor is concerned, the duties on rectified spirit removed/cleared for supply to industries (other than industries engaged in obtaining or manufacturing potable liquors) can be levied by the Centre and not by the States.[59]

85. Corporation Tax

A 'corporation tax' is a tax on income payable by companies, in case of which the following conditions are fulfilled:—(1) it is not chargeable in respect of agricultural income; (2) the companies paying the tax are not authorised to deduct the same from dividends payable by the companies to individuals; (3) no provision exists for taking

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54. *Union of India v. Bombay Tyre Int. Ltd.*, AIR 1984 SC 420 : (1983) 4 SCC 210.
The Gujarat High Court had ruled in favour of the broader concept of assessable value of goods in *Union of India v. Tata Chemicals*, 1983 Tax LR 2837. But the Madras High Court's view was negative: *Kanph Labs v. Union of India*, 1983 Tax L R 2845.

55. *M.P. Cement Manufacturers' Assn. v. State of M.P.*, (2004) 2 SCC 249, at page 256 : (2005) 11 JT 342.

56. *Scholey v. Rew*, 23 Wall. 331 (1874): *Knowlton v. Moore*, 178 U.S. 41; *Flint v. Stone Tracy Co.*, 220 U.S. 107; *Pacific Insurance Co. v. Soule*, 7 Wall 433; *Springer v. U.S.*, 102 U.S. 586.

57. *Parton v. Milk Board*, 80 CLR 229; *Dennis Hotels Pty. Ltd. v. Victoria*, 104 CLR 529.

58. *Atlantic Smoke Shops Ltd. v. Conlon*, 1943 A.C. 550; *Cairns Construction Ltd. v. Government of Saskatchewan*, 1960 S.C.R. 619; BORA LASKIN, CANADIAN CONSTITUTIONAL LAW, 671 (1975); JAIN, *Taxing Powers in Canada*, note 1, at 495, *supra*.

59. *Synthetics & Chemicals Ltd. v. State of Uttar Pradesh*, AIR 1990 SC 1927 : (1990) 1 SCC 109; *Bihar Distillery v. Union of India*, AIR 1997 SC 1208, 1218 : (1997) 2 SCC 727; *State of U.P. v. Vam Organic Chemicals Ltd.*, (2004) 1 SCC 225 : AIR 2003 SC 4650.

the tax so paid into account in computing for the purposes of income-tax the total income of individuals receiving such dividends or in computing the income-tax payable by or refundable to, such individuals.[60]

86. Taxes on capital values of assets exclusive of agricultural land, of individuals and companies; taxes on the capital of companies

The Centre can levy wealth-tax under this entry. It is a tax on the total capital value of assets (including lands and buildings) minus the debts and liabilities and so falls under this entry.

The Wealth Tax Act enacted by Parliament was challenged on the ground that the expression 'net wealth' in that Act included non-agricultural lands and buildings and so the tax fell within the domain of the State Legislatures under entry 49, List II.

The Supreme Court rejected the contention and ruled that wealth-tax is not levied directly on land and building, it is levied on the total assets of a person of which land building may be a component and so wealth tax does not fall under entry 49, List II which envisages the levy of tax on lands and buildings or both as units. Tax on lands and buildings is directly imposed on lands and buildings and bears a definite relation to it. Entry 49 is more general in nature, while entry 86 is more specific in nature. Therefore, in case of conflict between entry 86, List I, and entry 49, List II, entry 86 prevails. [61]

Applying the rule that an entry must receive wide, and not a narrow or restrictive, interpretation, it has been held that the expression 'individuals' in this entry includes a Hindu undivided family as well.[62]

87. Estate duty in respect of property other than agricultural land

88. Duties in respect of succession of property other than agricultural land

Entries 87 and 88 may be read together. 'Estate duty' means a duty to be assessed with reference to the principal value of all property passing upon death or deemed to pass under the said law [Art. 366(9)]. A common element of succession and estate duties is that the occasion for their levy is the death of a person. The succession duty is levied in respect of succession to property; the estate duty is levied on the property itself, has relevance to its value, and is independent of the question as to who takes it.[63]

In India, the area of succession and estate duties is divided between the Centre and the States according as whether the property is 'non-agricultural' or 'agricultural'. The former falls within the Central sphere, while the latter falls within the State sphere (Entries 47 and 48 in List II).[64]

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60. *Art. 366(6).*

61. *Sudhir Chandra Nawn v. W.T.O.*, AIR 1969 SC 59 : 1969 (1) SCR 108; *Asst. Commr. of Urban Land Tax v. B & C Co.*, AIR 1970 SC 169 : (1969) 2 SCC 55; *CWT v. Karan Singh*, 1993 Supp (4) SCC 500; *Lt. Colonel Sawai Bhawani Singh v. State of Rajasthan*, (1996) 3 SCC 105.

62. *Banarsi Das v. Wealth Tax Officer, Spl. Circle, Meerut*, AIR 1965 SC 1387, 1389 : (1965) 2 SCR 355.

63. *In re Estate Duty*, AIR 1944 FC 73.

64. *Infra*, Sec. D.

When the question of levying an estate duty was considered, it was felt that it would be inequitable to levy it only in respect of non-agricultural property and leave agricultural land untaxed. There were also problems of aggregation of the assessee's entire property when it might be interspersed over more than one State.

In order to have uniformity in the area it was thought desirable to have recourse to Art. 252.[65] A number of States authorised Parliament to legislate for levying estate duty in respect of agricultural land. In this way it became possible for Parliament to enact the Estate Duty Act applying to all properties.[66]

89. Terminal taxes on goods or passengers carried by railway, sea or air; taxes on railway fares and freights:

The nature of 'terminal tax' has been discussed under entry 52, List II.[67] Also see, entry 56, List II.[68]

90. Taxes other than stamp duties on transactions in stock exchanges and futures markets:

Entry 48, List I, relates to stock exchanges and futures markets.[69] Thus, the whole area of stock exchanges falls to the Centre. This has been done in view of the far reaching effects on public credit and finance of stock exchange transactions.

91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

See Entry 63 of List II.

92. Taxes on the sale or purchase of newspapers and on advertisements published therein:

The general sales tax falls in the State List under entries 54 and 55.[70] But sales tax on newspapers has been made a Central subject. This has been done so as to protect newspapers, which have an intimate connection with the fundamental right of speech and expression, from indiscriminate taxation.

92-A. Taxes on the sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-State trade or commerce

See under "Restrictions on the States' Power to levy Sales Tax" discussed later in this Chapter.[71]

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65. *Supra*, Ch. X, Sec. J.
66. The Estate Duty Act, 1953 was repealed by Act 20 of 2000.
67. *Infra*, Sec. D.
68. *Ibid.*
69. *Supra*, Ch. X, Sec. D.
70. *Infra*, Sec. D.
71. *Infra*, Sec. J(i).

92-B Taxes on the consignment of goods (whether the consignment is to the person making it or to any other person) where such consignment takes place in the course of inter-State trade or commerce.

This entry has been added to the Constitution by the Constitution (Forty-Sixth Amendment) Act, 1982.[72] The taxable event is despatch/consignment of goods.

It was held that the mere consignment of goods by a manufacturer to his own branches outside the State does not in any way amount to a sale or disposal of goods as such.[73] Accordingly, the 46th Constitution Amendment was enacted. It was felt that leakage of tax leviable under the Central Sales Tax Act on interstate sales of goods occurred through the device of consignment of goods from one State to another.

Reference may also be made to Art. 269[74] in this connection.

The effect of the various amendments made by the 46th Amendment is to expressly bring within the legislative competence of Parliament the field of taxation on the consignment/despatch of goods in the course of interstate trade or commerce. Under Art. 269(3), Parliament may by law formulate principles for determining when a consignment of goods takes place in the course of inter-state trade and commerce. A State law imposing such a tax was declared to be invalid.[75]

92-C. Taxes on Services

This Entry was introduced in 2003 by a Constitutional Amendment.[76] Previously service tax was levied under Entry 97 having been introduced by Parliament under Chapter V of the Finance Act, 1994. The 1994 Act was amended from time to time by extending the meaning of taxable service. By 2003, there were about 100 taxable services. Apart from the legislative categories, the courts have upheld levies under this entry with relation to other activities.

Thus, a tax on services rendered by mandap-keepers and outdoor caterers was held to be in pith and substance, a tax on services and not a tax on sale of goods or on hire-purchase activities.[77] Service provided to a subscriber by the telegraph authority in relation to a telephone connection with effect from the coming into force of the 1994 Act is also a taxable service.[78]

The ambit of the Entry was succinctly laid down in *All-India Federation of Tax Practitioners v. Union of India*,[79] while upholding Parliament's legislative competence to levy service tax on chartered accountants, cost accountants and architects:

> "Broadly 'services' fall into two categories, namely, property based services and performance based services. Property based services cover service provid-

72. Also, see, *infra*, under Sec. D.
For the 46th Constitution Amendment, see, *infra*, Ch. XLII.

73. *Goodyear India v. State of Haryana*, (1983) 53 STC 163. See also *Karya Palak Engineer v. Rajasthan Taxation Board*, (2004) 7 SCC 195 : AIR 2004 SC 4499.

74. *Infra*, Sec. K.

75. *Goodyear India Ltd. v. State of Haryana*, AIR 1990 SC 781 : (1990) 2 SCC 71.

76. Constitution (Eighty-eighth Amendment) Act, 2003.

77. *T.N. Kalyana Mandapam Assn. v. Union of India*, (2004) 5 SCC 632, at page 651 : AIR 2004 SC 3757.

78. *Bharat Sanchar Nigam Ltd. v. Union of India*,(2006) 3 SCC 1 : AIR 2006 SC 1383.

79. (2007) 7 SCC 527, at page 537 : AIR 2007 SC 2990.

> ers such as architects, interior designers, real estate agents, construction services, mandapwalas, etc. Performance based services are services provided by service providers like stockbrokers, practising chartered accountants, practising cost accountants, security agencies, tour operators, event managers, travel agents, etc."

96. Fees in respect of any of the matters in the Union List, but not including fees taken in any court, except the Supreme Court.

Fees taken in the Supreme Court is a Central subject under entry 77, List I.[80] Fees taken in all other courts is a State matter under entry 3, List II.[81] Fees taken elsewhere in respect of all matters in the Union List fall within the Central sphere.

The nature and scope of the term 'fee' have been discussed later.[82]

97. Any other tax not enumerated in Lists II and III

This is known as 'residuary taxes'. This topic is discussed later.[83]

COMMENTS

An examination of the two groups of entries in this list (legislative entries 1-81; taxing entries 82 to 97) indicate that while the main subject of legislation falls in the first group, a tax in relation thereto is separately mentioned in the second group. For example, entry 22 in List I is "Railway", and entry 89 is "Terminal Taxes on goods or passengers carried by railway, sea or air; taxes on railway fares and freights". Such examples can be multiplied, *e.g.* see entries 41 and 83; entries 43, 44 and 85.

This means that if the general entry were to be interpreted so broadly as to include the taxing power as well, then the taxing entry would become superfluous. Thus, for legislative purposes, a general legislative entry does not comprise taxing powers. Taxation is treated as a separate and distinct matter for purposes of legislative competence.[84]

D. STATE TAXES

Entries 1 to 44 in this List confer general legislative powers on the State Legislatures while entries 45 to 63 confer taxing powers on them. The following taxes are mentioned in the State List and are therefore leviable exclusively by the States.

45. Land revenue including its assessment and collection

This entry may be read along with entry 18 in this List concerning land.[85] Land revenue is a tax and not a rent for land.[86]

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80. *Supra,* Sec. H.
81. *Supra,* Ch. VIII; *infra,* Sec. H.
82. *Infra,* Sec. H.
83. *Infra,* Sec. G.
84. See *All India Federation of Tax Practitioness v. Union of India,* (2007) 7 SCC 527 : AIR 2007 SC 2990.
85. *Supra,* Ch X, Sec. E.
86. *Sesha Sarma v. State of A.P.,* AIR 1960 A.P. 461.

A cess based on the royalty derived from mining lands has been held as not falling under this entry as it cannot be regarded as land revenue. In the instant case, no tax was leviable if no mining activities were carried on. Thus, the tax was not related to land as a unit which is the only method of valuation of land under entry 49. The tax was relatable to minerals extracted.[1]

In a very interesting ruling,[2] the Supreme Court has held that a State can levy cess on the use of flowing water in a river under this entry. A factory owner was drawing water for industrial purpose from a river by installing water pumps at its bank. The State Government levied a cess on the use of the river water for industrial purpose under the State Land Revenue Code. The Court came to this conclusion by giving a very broad interpretation to the term 'land' in this entry. The Court pointed out that the code in question clearly included "flowing water, as investing title thereof in the State as integral part of land. The definition of 'land' includes the right to the water flowing therefrom as in the definition in the Transfer of Property Act".

46. Taxes on agricultural income

Taxes on non-agricultural income fall in the Central sphere, entry 82, List I.[3] 'Agricultural income' means agricultural income as defined for the purposes of the enactments relating to the Indian income-tax.[4] Therefore, the definition of agricultural income as given in the Indian Income-tax Act is controlling for the States which cannot extend their own jurisdiction by adopting a wider definition of the term agricultural income."[5]

According to Art. 274(1), a Bill to modify the meaning of agricultural income in the Income-tax Act cannot be moved in Parliament without the President's recommendation. There exists a demarcation between 'agriculture' and 'forestry' for legislative purposes,[6] but the term 'agricultural income' may include, for purposes of taxation, income from forestry.[7]

47. Duties in respect of succession to agricultural land.

48. Estate duty in respect of agricultural land.

These entries refer to passing of property to another on the death of a person and do not apply to transfers *inter vivos* and, therefore, a gift-tax would not fall within any of these entries. Also see entries 87 and 88 in List I.[8]

49. Taxes on lands and buildings.

This entry contemplates a levy of tax on lands and buildings or both as units. Such tax is directly imposed on lands and buildings and bears a definite relation

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1. *India Cement Ltd. v. State of Tamil Nadu,* AIR 1990 SC 85 : (1990) 1 SCC 12; *Orissa Cement Ltd. v. State of Orissa,* AIR 1991 SC 1676 : 1991 Supp (1) SCC 430.

2. *R.S. Rekchand Mohote Spg. & Wvg. Mills Ltd. v. State of Maharashtra,,* AIR 1997 SC 2590 : (1997) 5 SCC 511.

3. *Supra,* Sec. C.

4. Art. 366(1).

5. *Commr. of Income Tax v. Benoy Kumar Sahas Roy,* AIR 1957 SC 768 : 1958 SCR 101; *CIT v. Williamson Financial Services,* (2008) 2 SCC 202 : (2007) 13 JT 581.

6. See, entry 14, List II and entry 17A in List III, *supra.*

7. *CIT v. Benoy Kumar Sahas Roy,* AIR 1957 SC 768 : 1958 SCR 101. See also *Union of India v. Belgachi Tea Co. Ltd.,* (2008) 12 SCC 450 : (2008) 7 JT 114.

8. *Supra,* Sec. C.

to it. The expression 'lands' in this entry is wide enough to include agricultural land as well as non-agricultural land.[9] The word 'land' includes not only the face of the earth, but everything under or over it. Land remains land though it may be subjected to different user. Thus, a cesson mines and quarries, tea estates, and on mineral rights has been held to fall within this entry.[10]

Entry 49 contemplates a levy on land as a unit and the levy must be directly imposed on land and must bear a definite relationship to it. Land means the land on surface and also below the surface.

There is a clear distinction between tax directly on land and tax on income arising from land. [11] Wealth tax has been held to fall under entry 86, List I, and not under this entry.[12]

Gift tax is a tax on the *gift* of land; it is not a tax imposed directly on land but only on a particular user thereof, namely, transfer of land by way of gift.[13]

There is a difference between the levy on income from house property which is an "income-tax", and levy on house property itself which would be referable to this entry.[14]

An annual tax levied by a State on 'buildings and lands' on their annual value, payable by the owner, the annual value being determined by estimating the expected gross annual rent of the 'lands and buildings' less allowances and deductions for repairs and taxes, falls under this entry. Although the State tax adopts the same basis—'annual value'—for determining income from property, as is done by the Income-tax Act, yet in pith and substance the tax is on 'lands and buildings' and not on 'income.' "The method of arriving at the quantum of tax should not be mixed up with the nature of the tax itself."[15]

The Supreme Court has held that the annual rent actually received by a landlord can be taken as the annual rateable value of the property for the assessment of property tax under entry 49 in respect of a property not subject to rent control.[16] The tax remains property tax and cannot be regarded as a tax on income.

A tax on land or building can be imposed with reference to the income or yield therefrom. The income or yield of the land/building is taken merely as a measure of the tax; it does not change the nature or character of the levy; it still remains a tax on land or building. There is no set pattern of levy of tax on lands or build-

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9. *Raja Jagannath Baksh Singh v. State of Uttar Pradesh,* AIR 1962 SC 1563 : (1963) 1 SCR 220.

10. *State of W.B. v. Kesoram Industries Ltd.,* (2004) 10 SCC 201 : AIR 2005 SC 1646. See *infra* under Entry 50.

11. *Raja Jagannath, supra.* Also see, *Sudhir Chandra Nawn v. W.T.O.,* AIR 1969 SC 59 : 1969 (1) SCR 108; *New Manek Chowk Spinning & Weaving Mills Co. Ltd. v. Municipal Corp., Ahmedabad,* AIR 1967 SC 1801 : 1967 (2) SCR 679.

12. See, *supra*

13. *Second Gift Tax Officer v. D.H. Nazareth,* AIR 1970 SC 999 : (1970) 1 SCC 749; also see, *infra,* Sec. under Residuary Taxes.

14. *Bhagwan Dass Jain v. Union of India,* AIR 1981 SC 907 : (1981) 2 SCC 135.

15. *Ralla Ram v. East Punjab,* AIR 1949 FC 81; *D. Kasturchandji v. State of Madhya Pradesh,*, AIR 1967 MP 268; *Bhagwan Dass Jain v. Union of India,* AIR 1981 SC 907; *Union of India Cement Ltd. v. State of Tamil Nadu,* AIR 1990 SC 85 : (1990) 1 SCC 12.

16. *Govt. Servant Co-op. Building Socy. Ltd. v. Union of India,* AIR 1998 SC 2636 : (1998) 6 SCC 381.

ings. In *Goodricke*,[17] the Supreme Court upheld a cess levied by the State on tea estates, the cess being measured by the quantum of tea leaves produced in the estate. The cess was held as being a tax on land falling under entry 49. The Court observed:

> "A tax imposed on land measured with reference to or on the basis of its yield, is certainly a tax directly on the land. Apart from income, yield or produce, there can perhaps be no other basis for levy… There cannot be uniform levy unrelated to the quality, character or income/yield of the land. Any such levy has been held to be arbitrary and discriminatory".[18]

There is nothing in entry 49 to suggest that the tax on lands and buildings is to be paid only by the occupier and not by the owner. A tax on the use of land as a market falls under entry 49, as the incidence of the tax falls on land and the tax is to be levied only if land is used for particular purpose.[19] A cess was imposed on occupied land, based on its annual rent value. A tax can be levied on land used for extraction of minerals.[20]

This entry is not controlled by entry 54, List I. In case of tax on land held on a mining lease, royalty payable to the government may also be taken into account. It is a tax on 'land' falling within the present entry.[21]

A tax on property is based either on the capital value or on the annual letting value of the land and building and such a tax on the percentage of their capital value is valid.[22] If disregarding this basis, an impost is made merely on the basis of floor area of the building then such a tax may be bad being unequal or discriminatory.[23] No property tax could be levied on plant and machinery under this entry, for the taxing power extends only to lands and buildings.[24]

The word 'land' in the entry is broad enough to include all lands whether agricultural or not.[25] Though entry 49 refers to 'lands and buildings', it may not mean that a tax merely on "land" could not be imposed. The Supreme Court has said that the amplitude of the entry should not be curtailed; it should be construed as 'taxes on land' and 'taxes on buildings' and, therefore, a tax on 'land' alone can be levied.[26] Thus, a tax on a percentage basis of the market value of urban land falls under this entry and not under entry 86, List I .

The Municipal Corporation imposed a rate on vacant land within the municipal limits. The rate was the percentage of the valuation based upon capital. It was argued that this was a tax on capital and not a tax on property and was, therefore, beyond the legislative competence of the State. Holding the tax on land, the court

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17. *Goodricke Group Ltd. v. State of West Bengal,*, 1995 AIR SCW 123; *State of West Bengal v. Kesoram Industries Ltd.*, (2004) 10 SCC 201 : AIR 2005 SC 1646.

18. See, *K.T. Moopil Nair v. State of Kerala*, AIR 1961 SC 552 : (1961) 3 SCR 77; see Ch. XXI, *infra;* Ch. XXIV, *infra;* Ch. XXXI, *Infra*.

19. *Ajoy v. Local Board*, AIR 1965 SC 1561 : (1965) 3 SCR 47.

20. *Associated Cement Companies Ltd. v. State of Andhra Pradesh*, AIR 1983 AP 234.

21. *H.R.S. Murthy v. Collector of Chittoor*, AIR 1967 SC 177; *Western Coalfields v. Special Area Development Authority*, AIR 1982 SC 697 : (1982) 1 SCC 125; *Laxmi Narayan v. State of Orissa*, AIR 1983 Ori. 210.

22. *Sri Prithvi C. Mills v. Broach Municipality*, AIR 1970 SC 192 : (1969) 2 SCC 283.

23. *State of Kerala v. Haji Kutty*, AIR 1969 SC 378 : (1969) 1 SCR 645; *infra*, Ch. XXI.

24. *N.M.C.S. & W. Mills v. Ahmedabad Municipality*, AIR 1967 SC 1801 : (1967) 2 SCR 679; *Govt. of Andhra Pradesh v. H.M.T.*, AIR 1975 SC 2037 : (1975) 2 SCC 274.

25. *Jagannath v. State of Uttar Pradesh*, AIR 1962 SC 1563 : 1963 (1) SCR 220.

26. *Asst. Commr. v. B & C. Co.*, AIR 1970 SC 169 : (1969) 2 SCC 55.

emphasized the importance of the distinction between the levy of a tax and the machinery of its calculation including the method of calculation. The subject-matter of the tax was held to be something other than the measure provided to quantify tax by levying the tax on percentage of the capital value of the land taxed.[27]

In *D.G. Gouse & Co. v. State of Kerala*,[28] a question was raised about the validity of a tax on buildings levied by the State of Kerala. The tax was based on the 'capital value' of a building which was to be measured by its annual value. The argument was that it was 'wealth-tax' and so it could be levied only by the Centre and not the State. The Supreme Court rejected the argument saying that a tax levied on 'all that one owns', or on one's total assets, would fall within the purview of entry 86, List I[29] and so would be outside the purview of a State Legislature.

But a tax directly on one's buildings will be a tax, not under entry 86, List I, but under entry 49, List II. The Court also ruled that the method for determining the capital value of a building on the basis of its annual value cannot be regarded as hypothetical and arbitrary. There is no illegality in capitalising the gross income of the property for the purpose of determining the value of the property. It is not invalid to treat the 'expected gross annual rent' as the 'annual value' of a property. It is not wrong to multiply the annual value of a building by 16 to arrive at its capital value for tax purposes, for the quantum of the tax levied by the taxing statute, and the conditions subject to which it is levied, are matters within the competence of the legislature. So long as a tax is not confiscatory or extortionate, the reasonableness of the tax cannot be questioned in a court.'[30]

A cess based on royalty derived from mining land is not a tax on land within the meaning of entry 49, List II.[31] A tax on royalty could not be said to be a tax directly imposed on land. A tax on income derived from land cannot be regarded as a tax on land.[32] Similarly, wealth tax which is a tax on the capital value of the assets of an individual is not a tax directly on land under entry 49. Wealth tax falls under entry 86, List I, and not under entry 49, List II.[33]

The Supreme Court has explained the scope of entry 49 in *Union of India v. H.S. Dhillon*[34]. The Court has laid down the following incidents of a tax under entry 49, List II:

(1) It must be a tax on units that is lands and buildings separately as units.

(2) The tax cannot be a tax on totality, *i.e.* it is not a composite tax on the value of all lands and buildings.

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27. *Patel Gordhandas Hargovindas v. Municipal Commissioner, Ahmedabad,* AIR 1963 SC 1742 : (1964) 2 SCR 608.

28. AIR 1980 SC 271 : (1980) 2 SCC 410.

29. *Supra,* Sec. C.

30. *Infra,* Arts. 14, 19, Chs. XXI and XXIV.

31. *Orissa Cement Ltd. v. State of Orissa,* AIR 1991 SC 1676 : 1991 Supp (1) SCC 430; *India Cement Ltd. v. State of Tamil Nadu,* AIR 1990 SC 85 : (1990) 1 SCC 12.
Also see, *infra,* under entry 50, List II.

32. *India Cement Ltd., ibid.*

33. *S.C. Nawn v. W.T.O.,* AIR 1969 SC 59 : (1969) 1 SCR 108; *Lt. Col. Sawai Bhawani Singh v. State of Rajasthan,* (1996) 3 SCC 105.
Also see, *supra,* Sec. C.

34. AIR 1972 SC 106. Also see, *infra,* Sec. G, under "Residuary Taxes".

(3) The tax is not concerned with the division of interest in the building or land. In other words, the tax is not concerned with the division of interest in the building or land; in other words, the tax is not concerned whether one person owns or occupies it or two or more persons own or occupy it.

In pith and substance, the tax under entry 49 is not a personal tax but it is a tax on property.

A tax on excavation of land and use of forest land for non-forest use, and not on the forest land, as such, is not valid under entry 49. What is sought to be taxed in the instant case is not land but the tax is on absence of land. The forest land which is being used is not subjected to tax. The assessment of tax is on excavation and use of forest land for non-forest purpose. "The tax is levied in effect on the activity of the removal or excavation of land". Such a tax does not fall under entry 49 which envisages the levy of tax directly on land as a unit. "The land has been regarded as meaning the land on surface and also below the surface". Therefore, in order that a tax can be levied under entry 49, "it is essential that 'land' as a unit must exist on which the tax is imposed".[35]

Water charges levied by a municipality as a percentage of annual rateable value of building constitute a tax on lands and buildings falling under entry 49, List II.[36]

50. Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.

There has been a difference of opinion amongst the High Courts as regards the nature of royalty payable on minerals extracted from the mines. Some High Courts regard royalty as a tax under this entry,[37] while others treat it not as a tax but as the price paid for the privilege of exercising the right to explore the minerals, or as the payment made for the minerals won from the lands.[38]

The Supreme Court had earlier in *India Cement* expressed the view that royalty is a tax.[39]

However, in *State of W.B. v. Kesoram Industries Ltd*.,[40] it was clarified that royalty is not a tax, having corrected what was perceived as a typographical error in the majority view in *India Cement*.[41]

Subject to the provision of List I the power of the States to enact legislation on the topic of mines and mineral development is plenary. Legislation by the Union in the field covered by List I, Entries 52 and 54 would not like a magic touch or taboo denude the entire field forming the subject matter of the declarations required to be made under List I, Entries 52 & 54.[42]

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35. *State of Bihar v. Indian Aluminium Company*, AIR 1997 SC 3592, 3599 : (1997) 8 SCC 360.
36. *Kendriya Nagrik Samiti, Kanpur v. Jal Sansthan*, AIR 1982 All. 406.
Also, *Raza Buland Sugar Co. v. Rampur Minicipality*, AIR 1965 SC 895 : 1965 (1) SCR 970.
37. *Laddu Mal v. State of Bihar*, AIR 1965 Pat. 491; *Laxminarayan Mining Co. v. Taluk Development Board*, AIR 1972 Mys. 299.
38. *H.R.S. Murthy v. Collector of Chittoor*, AIR 1965 SC 177 : (1964) 6 SCR 666; *Saurashtra Cement & Chemical Industries Ltd. v. Union of India*, AIR 1976 Guj. 180; *Laxmi Narayan v. State*, AIR 1983 Ori. 210; *Dr Shanti Saroop Sharma v. State of Punjab*, AIR 1969 P&H 79.
39. *India Cement Ltd. v. State of Tamil Nadu*, AIR 1990 SC 85 : (1990) 1 SCC 12; also see, *infra*.
40. (2004) 10 SCC 201 : AIR 2005 SC 1646.
41. (*Ibid* at p. 297).
42. *State of W.B. v. Kesoram Industries Ltd.*, (2004) 10 SCC 201 : AIR 2005 SC 1646.

A reasonable tax or fee levied by State legislation can not be construed as trenching upon the Union's power and freedom to regulate and control mines and minerals. Moreover, the States power to tax under List II Entries 49 and 50 is not taken away by the residuary power of legislation of the Union in the field of taxation under Art. 248(2) read List I Entry 97.[43]

A tax on mineral rights would be different from tax on minerals extracted, as the latter tax amounts to excise duty. The tax on mineral rights is a tax on the right to extract minerals.[44]

The competence of the State Legislature under this entry is circumscribed by "any limitations imposed by Parliament by law relating to mineral development".

The State of Orissa levied a tax on mineral or coal bearing lands. The tax was based on "average annual income". The Supreme Court ruled in *Mahanadi*[45] that the tax in question was not a tax on land as it had nothing to do with the surface characteristic of the land and so it did not fall under entry 49, List II. It was, in substance, a tax on minerals and mineral rights and so it fell under entry 50, List II.

The State power to levy a tax under this entry was subject to limitations imposed by Parliament by law relating to mineral development. As Parliament had enacted the Mines and Minerals (Dev. & Reg.) Act under entry 54, List I, making exhaustive provisions covering all kinds of taxation on minerals and mineral rights—tax, royalty, fee, dead rent *etc*., the State Legislature was deprived or denuded of the power to enact any law imposing any tax or levy under entry 50, List II. Accordingly, the tax in question was held to be beyond the competence of, and *ultra vires* the legislature.

It was held that by virtue of the Mines and Minerals Regulation and Development Act, enacted by Parliament under entry 54, List I, the State Legislatures are denuded of their power to levy any tax on minerals. Entry 50 had practically become a dead letter.[46]

Mahanadi was overruled by *Kesoram* which held that a tax or fee on mineral rights which remains in pith and substance a tax for augmenting the revenue resources of the State or a fee for rendering services by the State and does not impinge upon regulation of mines and mineral development or upon control of industry by the Central Government is not unconstitutional.[47]

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43. *State of W.B. v. Kesoram Industries Ltd.*, (2004) 10 SCC 201 : AIR 2005 SC 1646.

44. WANCHOO, J., in *Hingir Rampur Coal Co. v. State of Orissa,* AIR 1961 SC 459 : (1961) 2 SCR 537.

45. *State of Orissa v. Mahanadi Coalfields Ltd.*, AIR 1995 SC 1868; *State of Madhya Pradesh v. Mahalaxmi Fabric Mills Ltd.,* AIR 1995 SC 2213 : 1995 Supp (1) SCC 642; *Saurashtra Cement and Chemical Industries v. Union of India*, AIR 2001 SC 8.

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

47. **Ed.:** The strained interpretation on the statutes which were the subject matter of challenge in the decision was the outcome of a perception of the majority that the Centre was consuming the lion's share of revenue and therefore in case of conflict, the "flexible" provisions of the Constitution should be interpreted in favour of the States who were the weaker and more needy and that "Any conscious whittling down of the powers of the State can be guarded against by the courts".

This propounds the long since discredited State rights doctrine which has the potential of weakening the federalist structure envisaged in the Indian Constitution. (infra p 741). See also the dissenting view of Sinha J in Kesoram at page 361.

Several States levied a 'cess' based on the royalty payable by a lessee on the extraction of minerals from the mining lands. The question of constitutional validity of the cess came before the Supreme Court in *Orissa Cement Ltd. v. State of Orissa.*[48] The States argued that in pith and substance the tax was a tax on land. The Court rejected the contention and ruled against the validity of the cess in question.[49]

The Court ruled that the cess could not be regarded as land revenue and thus it would not fall under entry 45, List II. The cess could also not be considered as a tax on mineral rights and would thus not fall under entry 50, List II. The cess could not also be considered as a tax on land within the meaning of entry 49, List II. Royalty is payable on the extraction from land and cess is an additional charge on that royalty. The impact of the cess in question would be on the royalties derived from land and not on land.

Entry 49, List II contemplates a levy on land as a unit and the levy must be directly imposed *on land* and must bear a definite relationship to it. There is a clear distinction between tax directly on land and tax on income arising from the land.[50] Royalty being indirectly connected with land can not be said to be a tax directly on land. Cess is relatable to minerals extracted from land. Under the State Act in question, no tax could be levied if no mining activities were carried on. "Hence, it is manifest that it is not related to land as a unit which is the only method of valuation of land under Entry 49 of List II, but is relatable to minerals extracted."

The cess could not also be regarded as a fee so as to fall under entry 66, List II.[51] The reason is that the levy could not be correlated to any services rendered by the State to the class of persons from whom the levy was collected. Entry 23 to which the levy of the fee could be related is "subject to the provisions of List I with respect to regulation and development" of mines and minerals under the control of the Centre. The Centre has enacted the Mines and Minerals Development Act, 1957. "It, therefore, follows that any State Legislation to the extent it encroaches on the field covered by the M.M.D. Act, 1957, will be *ultra vires*".[52] The cess could not also be regarded as covered by entry 18, List II, *viz.*, land.[53]

An outstanding feature of the judgment in *Orissa Cement* is that after holding the cess in question as unconstitutional, the Court made a ruling that no refund of cess already collected need be made. The cess was being collected since 1964 and a direction to refund all the cess collected would work hardship and injustice. In

48. AIR 1991 SC 1676 : 1991 Supp (1) SCC 430.

49. Reference was made to the following earlier cases: *Hingir Rampur* case, AIR 1961 SC 459 : (1961) 2 SCR 537; *supra, Tulloch,* AIR 1964 SC 1284 : (1964) 4 SCR 461, *supra; Murthy* case, AIR 1965 SC 177 : (1964) 6 SCR 666; *supra*, footnote 38.

50. *Orissa Cement Ltd. v. State of Orissa,* AIR 1991 SC 1676 : 1991 Supp (1) SCC 430; *India Cement Ltd. v. State of Tamil Nadu,* AIR 1990 SC 85 : (1990) 1 SCC 12.
Also see, *infra.*

51. For discussion on 'Fee', see, *infra,* Sec. H.

52. AIR 1991 SC at 1701. For the various entries mentioned here, see, *supra.* Also see, *India Cement Ltd. v. State of Tamil Nadu,* AIR 1990 SC 85 : (1990) 1 SCC 12; *State of Madhya Pradesh v. Mahalaxmi Fabric Mills Ltd.*, AIR 1995 SC 2213 : 1995 Supp (1) SCC 642.

53. *Supra*, Ch. X, Sec. E.

granting relief, the Court exercises certain amount of discretion. The Court observed on this point:[54]

> "It is a well-settled proposition that it is open to the Court to grant, mould or restrict the relief in a manner most appropriate to the situation before it in such a way as to advance the interests of justice.

In entry 49, the term land may, in certain circumstances, include minerals under the earth. But, as tax on mineral rights is expressly covered by entry 50, if it is brought under entry 49, it would render entry 50 redundant. Entries cannot be interpreted in such a manner so as to render any entry redundant.

51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India: (a) alcoholic liquors for human consumption; (b) opium, Indian hemp, and other narcotic drugs and narcotics, but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

The nature of an 'excise duty' has already been discussed earlier.[55] The area of excise duties has been divided between the Centre and the States.[56] The power of the State Legislatures to levy duties of excise is circumscribed under entry 51, List II. Levying of excise by Parliament under entry 84, List I, on medicinal and toilet preparations containing alcohol, does not debar the States from levying excise under this entry on alcoholic requirements for human consumption.[57]

The Constitution distributes the power to levy excise duties on alcoholic liquors between the Centre and the States. Entry 81, List I, and entry 51, List II, compliment each other. Both provide for levy of excise duties. States have no power to levy excise on alcohol which is not for human consumption. Such a tax can be levied only by the Centre.

The States cannot levy a tax or charge or impost on industrial alcohol, *i.e.* alcohol used and usable for industrial purposes as the States have no authority to levy duty or tax on alcohol which is not fit for human consumption. Such an impost can only be levied by the Centre under entry 84, List I. Entry 51 has been held to be limited to potable liquors. Thus, duties of excise on rectified spirit cleared/removed for the purposes of obtaining or manufacturing potable liquors is leviable by the State Governments.[58]

Since entry 51 is separate from entry 54, a State Legislature may impose simultaneously an excise tax as well as a sales tax on the same commodity. The word '*countervailing*' in this entry is significant as it means that countervailing duties can only be levied on goods entering the State from outside if similar

54. AIR 1991 SC at 1717.
Also see, *India Cement Ltd. v. State of Tamil Nadu,* AIR 1990 SC 85 : (1990) 1 SCC 12.

55. *Supra*, see, under entry 84, List I, Sec C.

56. See entry 84, List I, *supra*.

57. *Southern Pharmaceuticals & Chemicals v. State of Kerala,* AIR 1981 SC 1863 : (1981) 4 SCC 391.

58. *Synthetics & Chemicals Ltd. v. State of Uttar Pradesh*, AIR 1990 SC 1927 : (1990) 1 SCC 109; *State of UP v. Vam Organic Chemicals Ltd.,* (2004) 1 SCC 225 : AIR 2003 SC 4650. *Mohan Meakin Ltd. v. State of H.P.*, (2009) 3 SCC 157 : (2009) 1 JT 599; see, *supra*, under Entry 8, List II; *Bihar Distillery v. Union of India*, AIR 1997 SC 727 : AIR 1997 SC 1208.

goods are being manufactured within the State and excise duties are being levied thereon.[59] The underlying idea is to equalize the tax burden on home production and imports so that the local manufacturer is not at a disadvantage.

Under this entry tax is leviable on 'entry' of goods and not on goods being taken out. The tax under this entry has nothing to do with consumption of the commodity brought from outside the State.[60]

It will be seen from the perusal of the various entries in the three Lists that a substance may fall under several entries for various purposes. Thus, for purposes of cultivation and manufacture, opium falls under entry 59 of List I and it is exclusively a Central subject. For purposes of levy of excise, and for such control as may be necessary to collect the duty, opium falls under the present entry. Intoxicating liquor falls under entries 8 and 51 of List II, but may fall under entry 19 of List III if it is a drug.

'Narcotic' is a substance which relieves pain, produces sleep and in large doses brings on stupor, coma, and even death, as opium does. Chloral hydrate being hypnotic and sedative would be a narcotic and so an excise duty may be levied on it under the present entry.[61]

The Opium Act permits the States to levy duty as a condition for granting permission to possess, transport, import, export or sell opium. The Act has been enacted by Parliament. The Supreme Court has ruled in *Organon*[62] that the Act does not levy an excise duty on opium which can be levied only by a State Legislature and not by Parliament. Parliament can make a law under entry 59, List I, relating to cultivation, manufacture and sale for export of opium, or under entry 19, List III, with respect to opium generally.

Section 5 of the Opium Act enacted by Parliament empowers State Governments to make rules regulating the possession, transport, import, export and sale of opium subject to payment of duty or subject to such other conditions as it may impose. S. 5 is not a taxing provision. What S. 5 does is to authorise the State collect "amount" as a condition for granting the permission to possess, transport, import or sell opium. It does not amount to levying an excise duty on opium. S. 5 is, thus, constitutionally valid.

The Kerala General Sales Tax Act authorised the levy of turnover tax on the amounts of excise duty paid by the Kerala State Beverages Corporation on the distillers The duty on liquor was imposed under Section 17 of the Abkari Act in which it was described as a "duty of excise". The Supreme Court in *State of Kerala v. Maharashtra Distilleries Ltd.*,[63] held that the levy was not related to the manufacture of goods and could not be characterised as levy of excise duty even though it is so described in the Act but was relatable to Entry 8 of List II.

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59. *Kalyani Stores v. State of Orissa*, AIR 1966 SC 1686 : (1966) 1 SCR 865; *M.M. Breweries v. E.T. Commr. Chandigarh*, AIR 1976 SC 2020; *State of Orissa v. Niranjan Sen* (2004) 13 SCC 712; also see, *infra*, Ch. XV.

60. *M.M. Breweries, supra*, footnote 59.

61. *Indian C & P. Works v. State of Andhra*, AIR 1966 SC 713 : 1966 (2) SCR 110.

62. *Organon (India) Ltd. v. Collector of Excise*, AIR 1991 SC 2489.

63. (2005) 11 SCC 1 : AIR 2005 SC 2594.

A cess on shop-rent payable by the toddy-sellers to the State is not an excise as it has nothing to do with the production or manufacture of toddy.[64] The licence-fee stipulated to be paid to the State by licensed liquor vendors is neither a fee, nor a tax nor excise. This duty represents nothing but contractual sums payable to the State as the price or consideration or rental for the State parting with its privilege. This is on the theory that the State has exclusive right to manufacture and sell liquor and sell the said right to raise revenue. It is consideration for the privilege granted by the government for manufacturing or vending liquor.[65]

In *Sheopat Rai*,[66] the factual situation was as follows: the Excise Commissioner could grant a licence to a person for exclusive privilege of selling foreign liquor in retail in a locality against payment of fee for grant of the licence. The licence fee could be decided through an auction, the licence to be granted to the highest bidder. The Supreme Court ruled that the licence-fee is not a 'fee' and does not fall under entry 66, List II. It can also not be regarded as a tax and so it does not fall under entries 51 or 62, List II. The licence fee in the instant case connotes the idea of payment of a sum by a person to the grantor of a licence as consideration for conferring on him, by licence, the exclusive privilege or right to carry on certain activities in respect of foreign liquor, the carrying of which activities would have been otherwise the exclusive privilege or right of the grantor, *viz.*, the government. It is the consideration receivable by the State Government for parting with its exclusive privilege of vending foreign liquor in favour of a private party under a licence. It falls under entry 8, List II. The concepts of licence fee and excise duty are also entirely different.[67] No one has a Fundamental Right to carry on trade in any noxious and dangerous goods.[68]

52. Taxes on the entry of goods into a local area for consumption, use or sale therein

This duty is sometimes known as octroi duty. For this tax to become leviable, mere physical entry of the goods into the octroi area is not sufficient. The goods must not only enter the local area, but it must be "for the purpose of consumption, sale or use therein." The words 'consumption' and 'use' in the entry do not mean that the commodity must be destroyed or used up in the process, as a motor car. But when the commodity is converted into a different commercial commodity by subjecting it to some processing, it amounts to use and consumption of the commodity.[69] A municipal tax on wheat imported into the municipal limits by flour mills for converting it into flour by grinding, falls under this entry as conversion into flour involves user of wheat.

Even if the goods are sold within the local area, it must be for the purposes of consumption or use within that local area to be a sale for the purpose of entry

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64. *State of Mysore v. D. Cawasji & Co.*, AIR 1971 SC 152 : (1971) 2 SCR 799 : (1970) 3 SCC 710.

65. *Har Shankar v. Dy. Excise & Taxation Commr.*, AIR 1975 SC 1121 : (1975) 1 SCC 737; *State of Punjab v. Balbir Singh*, AIR 1977 SC 1717; *State of Punjab v. Ajudhia Nath*, AIR 1981 SC 1374 : (1981) 3 SCC 251.

66. *State of Uttar Pradesh v. Sheopat Rai*, AIR 1994 SC 813 : (1994) Supp (1) SCC 8; *State of Punjab v. Devans Breweries*, (2004) 11 SCC 26 : (2003) 10 JT 485.

67. *State of M.P. v. Lalit Jaggi*, (2008) 10 SCC 607 : (2008) 10 JT 510.

68. *Infra*, Art. 19(1)(g); Ch. XXIV, Sec. H.

69. *Travancore-Cochin v. Shanmugha Vilas Cashew Nut Factory*, AIR 1953 SC 333 : 1954 SCR 53; *HMM Ltd. v. Administrator, I Bangalore City Corp.*, AIR 1990 SC 47 : (1989) 4 SCC 595; *Mafatlal Industries Ltd. v. Nadiad Nagar Palika*, AIR 2000 SC 1223 : (2000) 3 SCC 1.

52.[70] If goods are sold within a local area for being taken out, and are actually taken out of that local area, such sale is not covered by entry 52.[71]

As the Supreme Court has explained, the levy of tax under entry 52 is "upon the entry of goods into a local area; *i.e.* upon entry of goods for the purpose of consumption, use or sale therein. Neither mere entry of goods is enough to attract the levy nor the mere sale thereof within the local area. What attracts the levy under entry 52 is the entry of goods into a local area for consumption or for use or for sale within that local area for the purpose of consumption or use within that local area."[72] The Supreme Court has observed in *Burmah Shell*:[73]

> "That concept (of octroi) included the bringing in of goods in a local area so that the goods comes to a repose there".

If the goods are not consumed, used or sold within the local area, no tax can be levied under this entry. Thus, where the goods merely pass through a local area to a destination beyond, no tax can be levied thereon. But, where goods are brought into a local area, stored or kept there for a sufficient length of time, and then re-exported, questions of identity and quantity of goods may arise.

A rule saying that if goods are not re-exported within six months, no refund will be allowed even if the goods are exported as a fact, has been held valid in *Telco*[74]. The Supreme Court observed : "The export cannot be put in perpetual doubt and the goods may be considered to have come to a repose if they were not exported within a particular period provided in the rules".

The State of Rajasthan imposed an entry tax on motor vehicles, purchased outside the State and brought into the State for use or sale. The tax has been held valid as falling under entry 52, List I, as the taxation event is the entry of the vehicle into a local area. The basis of the levy of the tax may be the purchase value of the vehicle, but it is not a tax on purchase of goods. The State is divided into local areas, *i.e.* municipalities/panchayats and, therefore, if the vehicle is brought within the local limits of any local area, the tax can be levied on such vehicle.[75]

A terminal tax leviable by Parliament under entry 89, List 1,[76] must be: (*a*) terminal, (*b*) confined to goods and passengers carried by railway, sea or air, (*c*) chargeable at a rail, sea or air terminus and be referable to services (whether of carriage or otherwise) rendered by some rail, sea or air transport organisation. On the other hand, the essential features of octroi duties under entry 52, List II, are—(*a*) the entry of goods into a definite local area, and (*b*) the requirement that the goods should enter for the purposes of consumption, use or sale therein.

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70. *Tata Engineering & Locomotive Co. v. Municipal Corporation, Thane,* AIR 1992 SC 645 : 1993 Supp (1) SCC 361.

71. *Entry Tax Officer v. Chandanmal Champalal & Co.,* (1994) 4 SCC 463; *Hindustan Petroleum Corp. Ltd. v. Okha Gram Panchayat,* (1994) Supp (1) SCC 296, 300 : AIR 1954 SC 916.

72. *State of Bihar v. Bihar Chamber of Commerce,* AIR 1996 SC 2344, at 2354 : (1996) 9 SCC 136 (overruled on another point in *Jindal Stainless Ltd. (2) v. State of Haryana,* (2006) 7 SCC 241 : AIR 2006 SC 2550).

73. *Infra,* footnote 79.

74. *Supra,* footnote 70.

75. *Rashid Mohd. v. State of Rajasthan,* AIR 1994 Raj 167.
Also see, *Jaika Automobile Pvt. Ltd. v. State of Maharashtra,,* AIR 1993 Bom. 124.

76. *Supra,* Sec. C.

A terminal tax and octroi have several common features. Both are interlinked—(*i*) destination of the goods; (*ii*) the user in the local area on arrival of goods. Where the goods merely pass through a local area without being consumed therein, none of these taxes may be levied. There is only a very little margin of difference between octroi and terminal tax. In case of terminal tax, the goods reach their final destination and their entry into the area of destination immediately attracts payment of terminal tax irrespective of their user. Octroi is levied on goods for their use and consumption. Cotton was being brought within the municipal limits not for sale but for processing into yarn. It was held that octroi was leviable on cotton as used by the mill.[77]

Under entry 52, tax is not leviable on entry of goods for any purpose other than consumption, use or sale.[78] No octroi can be levied on goods received in a local area if they are exported out.[79] Terminal tax, on the other hand, signifies that there must be terminus for the journey of the goods. Thus, where goods enter into a local area which is also the destination of the goods either temporarily or otherwise, the terminal tax would be leviable. When goods pass through a local area without being consumed there, to a destination beyond, the mere fact that the transport carrying the goods halts within the local area for transhipment or allied purposes would not justify the levy of octroi. It is necessary, however, that the goods leave for their destination within a reasonable time.[80]

Octroi refers to goods and not to passengers; it can be imposed only at the point of entry of goods; there is no limitation on the manner by which the goods enter whether by rail, air, road or waterway. Octroi cannot be collected at the point of exit of goods.[81] The terminal tax may be imposed both on entry or exit, and may refer to both passengers or goods.[82] Rail-borne goods may be subject to a terminal tax under entry 89, List I, and to an octroi under this entry.

What is the significance of the expression 'local area' in the present entry. The State of U.P. declared each sugar factory in the State as a 'local area' and imposed a cess on entry of sugarcane for consumption therein. The Supreme Court held in *Diamond Sugar Mills v. State of Uttar Pradesh*[83] that the cess was not validly levied under this entry as the term 'local area' signifies "an area administered by a local body like a municipality, a district board, a local board, a union board, a panchayat or some body constituted under the law for the governance of the local affairs of any part of the State. The premises of a factory can not regarded as a 'local area'.

A municipality can levy octroi duty on tobacco imported for manufacturing bidis. It does not matter if the Centre levies excise duty on tobacco, for these are two independent imposts arising from different sets of circumstances imposed by

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77. *Bhaskar Textile Mills v. Jharsuguda Municipality*, AIR 1984 SC 583 : (1984) 2 SCC 25.

78. *Jothi Timber Mart v. Calicut Municipality*, AIR 1970 SC 264; *Kunwar Ram Nath v. M.B., Pilibhit*, AIR 1983 SC 930 : (1983) 3 SCC 357.

79. *Burmah Shell v. Belgaum Municipality*, AIR 1963 SC 906 : 1963 Supp (2) SCR 216; *Hiralal Thakerlal Dalal v. Broach Municipality*, AIR 1976 SC 1446; *Indian Oil Corporation v. Union of India*, AIR 1982 Goa 26.

80. *Man Mohan Tuli v. Municipal Corp., Delhi*, AIR 1981 SC 991 : (1981) 2 SCC 467; *State of Karnataka v. Hansa Corporation*, AIR 1981 SC 463 : (1980) 4 SCC 697.

81. *Puri Fish Merchants Association v. Puri Municipal Council*, AIR 1988 Ori. 207.

82. *Punjab Flour Mills v. Lahore Corp.*, AIR 1947 FC 14; *Emperess Mills v. Municipal Committee*, AIR 1958 SC 341 : 1958 SCR 1102.

83. AIR 1961 SC 652 : (1961) 3 SCR 242; *infra*.

two governments.[84] Octroi can be levied on the commodity 'sold' for it can be regarded as 'consumed', although the purchaser may not consume the whole of it within the municipal limits but consume a part of it outside.

The Burmah Shell Company used to bring petrol within Belgaum municipal limits, consume a part of it, sell a part of it to consumers within the municipal limits for consumption outside, and export the rest outside the municipal limits. The Supreme Court held in *Burmah Shell v. Belgaum Municipality*[85] that except for the petrol exported, all petrol brought into the municipal limits was subject to the octroi tax. So long as the goods are brought inside the area for sale within the area to an ultimate consumer, it makes no difference that the consumer does not consume them in the area but takes them out for consumption elsewhere. All the act of consumption need not take place within the area of the municipality. "It is sufficient if the goods are brought inside the area to be delivered to the ultimate consumer in that area because the taxable event is the entry of goods which are meant to reach an ultimate user or consumer in the area"[86]

A municipal corporation levied an octroi duty on goods imported within its limits, but refunded only 90 per cent of the duty when goods were exported out within a specified period. It was held that the 10 per cent deduction amounted to a tax on octroi refund and such a tax could not be imposed under any entry in the State List.[87]

A municipality deriving its power to tax from the State Legislature obviously cannot have any authority more extensive than the authority of the State Legislature. Accordingly, a municipality cannot levy a tax in respect of goods brought into the local area for purposes other than consumption, use or sale.[88]

Under entry 52, List II, a State Legislature can levy a tax on the entry of goods for 'consumption, use or sale' into a local area.[89] Under entry 52, List II, not only a municipality or a local body can impose an octroi duty but even the State can impose a tax on goods entering a local area.

Both octroi and entry tax can be levied simultaneously as there is no constitutional bar against double taxation. Upon the same object and person separate taxes can be levied for different purposes by the same authority or different authorities.[90]

53. Taxes on the consumption or sale of electricity.

Under this entry, a State Legislature is competent to tax 'consumption' of electricity, whether produced by the consumer himself, or purchased from somebody else.[91] A levy of duty upon *consumption* of electrical energy is not a duty

84. *Ram Krishna v. Municipal Committee, Kamptee,* AIR 1950 SC 11 : 1950 SCR 15.
85. AIR 1963 SC 906 : 1963 Supp (2) SCR 216.
86. *Ibid,* at 912.
87. *Poona Municipality v. Dattatraya,* AIR 1965 SC 555 : (1964) 8 SCR 178.
88. *Indian Oil Corporation v. Municipal Corporation, Jullundhar,* AIR 1993 SC 844 : (1993) 1 SCC 333.
89. See, *Associated Cement Companies Ltd. v. State of Madhya Pradesh,* AIR 1996 MP 116.
90. *Jaika Automobiles Pvt. Ltd., Nagpur v. State of Maharashtra,,* AIR 1993 Bom 124.
91. *Jiyajeerao Cotton Mills v. State of Madhya Pradesh,,* AIR 1963 SC 414 : 1962 Supp (1) SCR 282.

of excise falling in entry 84, List I, because excise is a duty on 'production' and not 'consumption'.[1]

Electricity is goods which can be sold. As electricity cannot be stored, it can only be sold for consumption. Therefore, the word 'sale' in entry 53, List II must be read as 'sale for consumption' of electricity. Taxes on the consumption or sale for consumption of electricity within the meaning of entry 53 must be consumption within the State and not beyond its territory.[2]

According to a Constitution Bench of the Supreme Court because electricity is goods, it is covered in Entry 54 also. Therefore, Entries 53 and 54 must be read together and to the extent of sale of electricity for consumption is outside the State, the sale is subject to provisions of Entry 92-A of List I.[3]

Restrictions have been placed on the levy of this tax by Arts. 287 and 288. Art. 287 lays down that except in so far as Parliament may by law otherwise provide, a State cannot impose a tax on the consumption by, or sale of electricity (whether produced by a government or other persons) to, the Government of India; or electricity consumed in the construction, maintenance or operation of a railway by, or electricity sold for the purpose to, the Government of India or a railway company.

Even when Parliament authorises the imposition of such a tax, the law imposing or authorising it 'shall secure' that the price of electricity sold to the Government of India for consumption by it, or to railway company, is less by the amount of the tax than the price charged to other consumers of a substantial quantity of electricity. In other words, the incidence of the tax is to be on the producer of the electricity and not on the Government of India or the railway company.

The tenor of Art. 288 is that a State may by law impose a tax in respect of any water or electricity stored, generated, consumed, distributed or sold by any authority established by a law of Parliament for regulating or developing any inter-State river or river valley. Such a law to be effective should be reserved for the President's consideration and receive his assent. If the State law provides for the fixation of the rates and other incidents of such tax by means of rules or orders to be made under the law by any authority, the law must make provision for the previous consent of the President being obtained to the making of any such rule or order.

The purpose of the provision evidently is to protect the public utility services like railways and river valley projects from indiscriminate State taxation as these services have a national importance. Art. 288 does not stipulate Presidential assent for imposition of a fee for supply or use of water.

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1. See, *supra*, Sec. C.

2. *State of Andhra Pradesh v. NTPC Ltd.,* (2002) 5 SCC 203, 222 : AIR 2002 SC 1895; *State of A.P. v. National Thermal Power Corpn. Ltd.,* (2002) 5 SCC 203 : AIR 2002 SC 1895; *M.P. Cement Manufacturers Assocn. v. State of MP,* (2004) 2 SCC 249 : (2005) 11 JT 342. Observations to the contrary in *Southern Petrochemical Industries Co. Ltd. v. Electricity Inspector & ETIO,* (2007) 5 SCC 447 : AIR 2007 SC 1984 and *Karnataka Power Transmission Corpn. v. Ashok Iron Works (P) Ltd., (*2009) 3 SCC 240 : AIR 2009 SC 1905 appear to be incorrect.

3. *State of A.P. v. National Thermal Power Corpn. Ltd*., (2002) 5 SCC 203 : AIR 2002 SC 1895.

Article 288 is a corollary of the doctrine of "intergovernmental tax immunities", which is discussed later in this Chapter.[4] The subject of taxation under this clause is a matter of interstate utility and hence of national concern. The Presidential assent ensures that the State legislation does not injure interstate interests by imposing unduly high taxation on generation, storage *etc*. of electricity. The Presidential assent is a condition precedent for the validity of the State legislation imposing tax under Art. 288. It serves a very beneficial interest by way of protection of intergovernmental interests.

54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of list I

The power of the States to levy sales tax under entry 54 is subject to two limitations. One arises out of the entry itself, *viz*., the entry itself is subject to entry 92A of List I. Under entry 92-A, taxation of inter-State sales are subject to Central Laws. The other limitation flows from the restrictions embodied in Article 286.[5]

The power of the States to levy sales tax under entry 54 has generated massive case law.

Under entry 92, List I, only Parliament, and not a State Legislature, can levy a tax on "sale or purchase of newspapers". A newspaper is a paper containing a report of recent events. A paper which mainly gives astrological and numerological predictions is not a newspaper even though it may contain a stray news item, and, therefore, its sale can be taxed under the present entry.[6]

The term 'goods' for the purposes of this entry has been given a very wide connotation. According to Art. 366(12), "goods" includes "all materials, commodities, and articles." In *H. Anraj v. Govt. of Tamil Nadu*,[7] levy of sales tax on the sale of lottery tickets has been held to be valid. A lottery ticket has been held to be "goods". Electricity is goods. Tax on the sale and consumption of electricity falls both within entries 53 and 54. This means that tax on sale for consumption of electricity outside the taxing State would be subject to entry 92A, List I.[8]

In *Vikas Sales Corporation v. Commissioner, Commercial Taxes*,[9] REP licences have been held to be goods and transfer of such a licence by its holder to another person constitutes a sale of goods and sales tax can be levied thereon. REP licences are import licences issued to the exporters to enable them to import the necessary inputs required for the manufacture of products exported. REP licences have an inherent value of their own and are bought and sold as such. In the commercial world, these licences are treated and dealt with as merchandise.

The expression 'sale of goods' in the entry has been given the same meaning as in the Sale of Goods Act. Therefore, an attempt by a State Legislature to im-

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4. *Infra*, Sec. J(ii), under Immunity of Instrumentalities.

5. For discussion on Art. 286, see, *infra*, Sec. J(i).
Also see, *20th Century Finance Corp. Ltd. v. State of Maharashtra*,, AIR 2000 SC 2436 : (2000) 6 SCC 1.

6. *Commissioner of Sales Tax v. Express Printing Press M/s*, AIR 1983 Bom 190.

7. AIR 1986 SC 63 : (1986) 1 SCC 414.

8. *State of Andhra Pradesh v. NTPC Ltd.*, (2002) 5 SCC 203 : AIR 2002 SC 1895.

9. AIR 1996 SC 2082 : (1996) 4 SCC 433.

pose tax on a transaction which was not a sale according to this Act was held to be unconstitutional. [10]

To constitute a sale, therefore, (a) there should be an agreement between the parties for transferring title to goods, (b) supported by money consideration, and as a result of the transaction, (c) property must actually pass in the goods. There can be no sale without all these three ingredients being present.

There is a well defined distinction between 'sale' and an "agreement to sell". It was held in the instant case [*Dunkerley*] that in a building contract which was one, entire and indivisible, there was no sale of goods and was not within the competence of the State Legislatures under entry 54. A sale by auction is a 'sale' and sales tax can be imposed on auctioneers.[11] Forward contracts are not subject to taxation under this entry as no property in goods passes under such an agreement and, therefore, it is merely an agreement to sell and not a completed sale.[12]

The term 'goods' in this entry means all kinds of movable property. Electricity is 'goods' and thus can be subjected to sales tax.[13] Sales tax on petroleum and petroleum goods falls under this entry and not under entry 53 of List I.[14] It had been initially held in *State of U.P. v. Union of India*,[15] that providing telephone service by the Department of Telecommunications which comprises allotment of number, installation of an instrument/apparatus and other appliances at the premises of a subscriber, which are connected with a telephone line to the area exchange for access to the whole system, to dial and to receive calls, in effect falls within the meaning of the extended definition of "sale" for the purpose of imposition of a State tax under this Entry. The view was overruled in *Bharat Sanchar Nigam Ltd. v. Union of India,*[16] which dealt with taxation of mobile phone connections. The sale of handsets and SIM cards were disaggregated and the argument that the "goods" element in telecommunication was theelectromagnetic waves by which data generated by the subscriber was transmitted to the desired destination, was negatived.

A State tax on purchase of sugarcane at a rate regulated by weight and not value falls under this entry.[17] It is a pragmatic novelty in the sales tax pattern. It is not an excise (which falls under entry 84, List I)[18] as the tax is levied on the purchase of cane and not on its conversion into sugar. Although, usually, purchase tax is levied with reference to the price of goods, the legislature can levy such a tax with reference to the weight of the goods purchased.

The sugar industry is a 'controlled' industry (entry 52, List I),[19] and a tax on raw materials for sugar may be a tax with respect to that industry, yet such a tax does not fall outside the purview of the State Legislature[20] under entry 54, List II. It was held that the subject matter of sales tax covered by entry 54, List II, cannot

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10. *State of Madras v. Gannon Dunkerley*, AIR 1958 SC 560 : 1959 SCR 379.
11. *C.S. Bureau v. I.T. Commr.*, AIR 1973 SC 376 : (1973) 1 SCC 46.
12. *Sales Tax Officer v. Budh Prakash*, AIR 1954 SC 459 : (1955) 1 SCR 243.
13. *S.T. Commr., Indore v. M.P.E. Board*, AIR 1970 SC 732 : (1969) 1 SCC 200.
14. *Supra*, Ch. X, Sec. D.
15. (2003) 3 SCC 239 : AIR 2003 SC 1147.
16. (2006) 3 SCC 1 : AIR 2006 SC 1383; See also *supra* under Central Taxes: Entry 92-C.
17. *Ganga Sugar Corporation v. State of Uttar Pradesh*, AIR 1980 SC 286 : (1980) 1 SCC 223.
18. *Supra*, Sec. C.
19. *Supra*, Ch. X, Sec. D.
20. See, *Tikaramji, supra; Kannan Devan, supra.*

be included in entry 52, List I, as entry 54, List II, is a "separate and independent field."[21]

A State levy at the point of first purchase of alcohol has been held to be valid under this entry.[22] 'Industry' as a legislative topic is of large and liberal import, but "what peripherally affects cannot be confused with what goes to the heart". Sales tax on raw materials may affect costing process of manufacture but it is not legislation on industrial process or allied matters.[23] This calls for application of the rule of pith and substance.[24]

Entry 54 uses two terms 'sale' and 'purchase'. Both are two sides of the same coin. Sale and purchase are merely two sides of the same transaction. From the point of view of the seller, the transaction is a 'sale'; looked at from the point of view of the buyer, the same transaction is a purchase. Under entry 54, the State Legislature may levy both—'sales tax' as well as 'purchase tax'. A tax on the purchase of bamboo is valid under this entry.[25]

The characteristics of a 'sale' have been mentioned above. Before 1982, a number of transactions were held as not being 'sale' and, thus, not subject to sales tax under this entry. A contract of sale of goods was distinguished from a contract for works and labour. In the former case, the main object is transfer of property; in the latter, the main object is not transfer of property but to provide work and labour. For instance—

(a) Supply of materials in execution of works contract was held to be not sale of goods by the contractor as a building contract was held to be one entire and indivisible contract.[26]

(b) Supply of steam by the electricity board to Nepa Mills on actual cost basis was held to be more akin to a labour contract than to sale.[27]

(c) When the assessee redried raw tobacco, packed it in waterproof packing material, and charged one inclusive rate for drying and packing, there was no sale of packing material in such a case as the material was used in execution of a work contract and thus the packing material could not be subjected to sales tax.[28]

(d) When a hotel made one consolidated charge for residence, services and food, without separating charges for food from charges for service, it was held that there was no sale of food, but it was a service rendered to the guests and so no sales tax could be levied on the food supplied.[29]

(e) Supply of refreshments to its members by a club on a no-profit basis was held to be not a sale and hence not subject to sales-tax.[30]

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21. *State of Uttar Pradesh v. Synthetics and Chemicals Ltd.,* (1991) 4 SCC 139.

22. *Ibid.*

23. *Supra,* Ch. X, Sec. D.

24. *Supra,* Ch. X, Sec. G(d).

25. *State of Orissa v. Titaghur Paper Mills Co. Ltd.,* AIR 1985 SC 1394 : (1985) 3 SCC 661.

26. *State of Madras v. Dunkerley, supra,* note 72; *Banarsi v. State of Madhya Pradesh,,* AIR 1958 SC 909 : 1959 SCR 427.

27. *S.T. Commr. v. M.P.E. Board,* AIR 1970 SC 732 : (1969) 1 SCC 200.

28. *State of Andhra Pradesh v. Guntur Tobaccos,* AIR 1965 SC 1396 : (1965) 2 SCR 167.

29. *Associated Hotels v. Excise & Tax Officer,* AIR 1966 Punj. 449.

30. *J.C. Tax Officer, Madras v. Y.M.A., Madras,* AIR 1970 SC 1212 : (1970) 1 SCC 462. This ruling went contrary to an earlier ruling in which sales tax was held leviable on supply of refreshments by a co-operative society to its members on a no-profit basis: *Dy C.T.O. v. Enfield India,* AIR 1968 SC 838 : (1968) 2 SCR 421.

A tax was levied on the purchase of sugarcane required for "use, consumption or sale in a factory." It was argued that the tax was not on every purchase of sugarcane but only "on the purchase of cane required for use, consumption or sale in a factory", the tax was not a purchase tax falling under entry 54, II, but a 'use' tax. It was also argued that since the tax was levied on the entry of cane into a factory for being used and consumed in the manufacture of sugar, the tax was, in the nature of an 'entry' tax but since the factory was not a 'local area' within the meaning of entry 52, List II, the levy was incompetent. But the Supreme Court rejected these arguments and held that the taxable event in the instant case was 'purchase of cane' and neither on "use or enjoyment of what is purchased" nor on "entry of cane into a factory", and, therefore it fell under entry 54, List II.[31]

Levy of a tax by a State on the purchaser in respect of the last sale of the goods in question, if otherwise the sale of the goods had not borne the tax earlier, has been held valid as being a tax on "purchase, pure and simple" and, as such, falling under entry 54, List II, as interpreted in "the widest possible manner". The Court refused to accept the argument that the tax was levied on "consumption, production or consignment".[32]

Despatch of sugar by the assessee to the authorised agent of a State under direction issued by the Sugar Controller under the Sugar and Sugar Products Control Order, 1946, was held not subject to sales tax as there was no sale since the contractual element was lacking in the transaction.[33] But there was some change in this judicial view later for in a similar situation the transaction was held subject to sales tax as, on facts, the Court found that the contractual element was not completely absent.[34]

Again, it was held that supply of wheat to the Food Controller under the Levy order was not a sale as there was no contract but only a legal obligation. There was not enough volition left to the parties to make the transaction contractual.[35] But this view has now undergone a change.[36] The view is now propounded that so long as mutual assent, express or implied, is not totally excluded, the transaction would amount to sale. The latest case in the series is *Food Corporation of India v. State of Kerala*[37] where levy procurement by the FCI under orders issued under the Essential Commodities Act have been held to be sale for purposes of entry 54 as some area of consensual arrangement and some field for volition is still left untouched by the law. "The disputed transactions are sales, may be, under the compulsion of a statute. Nevertheless, they are sales exigible to tax."[38]

Under the State law, the Cane Commissioner could declare any area as the factory zone for supply of sugarcane to a sugar mill. The factory was bound to purchase all sugarcane offered to it from the zone and the sugarcane producers in

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31. *Andhra Sugars v. State of Andhra Pradesh*, AIR 1968 SC 599 : (1968) 1 SCR 705.

32. *Hotel Balaji v. State of Andhra Pradesh*, AIR 1993 SC 1048, overruling *Goodyear Ltd. v. State of Haryana*, AIR 1990 SC 781 : (1990) 2 SCC 71.

33. *New India Sugar Mills v. S.T. Commr.*, AIR 1963 SC 1207 : 1963 Supp (2) SCR 459.

34. *I.S.W. Products v. State of Madras*, AIR 1968 SC 478 : (1968) 1 SCR 479.

35. *Chitter Mal v. S.T. Commr*., AIR 1970 SC 2000 : (1970) 3 SCC 809.

36. *Vishnu Agencies (Pvt.) Ltd. v. Commercial Tax Officer*, AIR 1978 SC 449 : (1978) 1 SCC 520; *State of Punjab v. Dewan's Modern Breweries*, AIR 1979 SC 1158 : (1979) 2 SCC 210; *Coffee Board, Bangalore v. Commr. of Commercial Taxes, Karnataka*, AIR 1988 SC 1487 : (1988) 3 SCC 263.

37. AIR1997 SC 1252 : (1997) 3 SCC 410.

38. *Ibid* at 1263.

the zone could not sell sugarcane to any other factory. The purchase of sugarcane by the factory was held liable to sales tax on the ground that the sugarcane producer enjoyed some freedom of contract as he was free to sell or not to sell his sugarcane to the concerned mill, although the mill was bound to purchase all the sugarcane offered to it.[39]

A hire-purchase agreement, it was held, was not an agreement of sale and so could not be subject to sales tax. No transaction in which no property passes from the seller to the buyer could be subject to sales tax. Only when such an agreement ripens into a sale it could be liable to sales tax.[40]

THE CONSTITUTION (FORTY-SIXTH AMENDMENT) ACT, 1982

Thus, various interpretations of the entry very much restricted the scope of the State taxing power. Sales tax constitutes a major source of revenue for the States. With a view to enhance their taxing capacity under this entry, the Constitution (Forty-Sixth Amendment) Act, 1982, has been enacted.[41] Cl. 29A has been added to Art. 366 so as to clarify the position in certain respects, to remove certain judicially imposed restrictions and to include the following transactions within the expression "a tax on the sale or purchase of goods":

(a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;[42]

(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;[43]

(c) a tax on the delivery of goods on hire-purchase or any system of payment by instalments;[44]

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration.[45]

Any of the above-mentioned supply, transfer or delivery of any goods is to be deemed to be a sale of those goods by the person making the transfer, delivery or

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39. *Andhra Sugars Ltd. v. State of Andhra Pradesh*, AIR 1968 SC 599 : (1968) 1 SCR 705.
40. *K.L. Johar & Co. v. Dy. C.T.O.*, AIR 1965 SC 1082 : (1965) 2 SCR 112.
41. See, *infra*, Ch. XLII, for this Amendment.
42. This overrides *New India Sugar Mills'* ruling, *supra*, footnote 33.
The Supreme Court had itself overridden this ruling in *Oil & Natural Gas Commission v. Bihar*, AIR 1976 SC 2478 : (1977) 1 SCR 354 and *Vishnu Agencies v. Commercial Tax Officer*, AIR 1978 SC 449 : (1978) 1 SCC 520.
43. This limits the ruling in *Dunkerley*, *supra*, notes 72 and 1. See *Bharat Sanchar Nigam Ltd. v. Union of India* (2006) 3 SCC 1 : AIR 2006 SC 1383.
44. This overrides the *Johar* ruling, *supra*, footnote 40.
45. This overrides the ruling in *Associated Hotels* case, *supra*.

supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made.

Cl. 29A of Art. 366 defines expansively the expression "tax on the sale or purchase" so as to include *inter alia* non-contractual transfer of property for valuable consideration, transfer of property in goods in execution of a works contract; delivery of goods on hire-purchase; and transfer of the right to use any goods for consideration. The purpose of these amendments is to augment the State revenue through sales taxation. The State Legislatures have thus become competent to levy sales tax on 'deemed sales' as envisaged in the above clauses from (a) to (f) even though such transactions were not sales within the meaning of 'sale' as contained in the Sale of Goods Act.[46] But the power of the States to tax sales mentioned in sub Cls. (b), (c) and (d) of Art. 366 (29A), mentioned above, is not unrestricted. According to Art. 286 (3)(b), a law of a State imposing tax on such sales is to be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify. The Supreme Court has also ruled that all transfers of goods mentioned in Cls. (a) to (b) above are subject to the restrictions contained in Art. 286.[47]

As regards Cl. (d), mentioned above, a question has arisen whether a State can levy sales tax on the transfer of the right to use any goods on the premise that the goods put to use are located there irrespective of the place where the agreement of such transfer of the right to use such goods is made. The Court has ruled that where a party enters into a formal contract and the goods are available for delivery irrespective of the place where the goods are located, the *situs* of such sale would be where the property in the goods passes, namely, where the contract is entered into. The Court has formulated the proposition as follows:[48]

> "Where the goods are in existence, the taxable event on the transfer of the right to use goods occurs when a contract is executed between the lessor and the lessee and *situs* of sale of such a deemed sale would be the place where the contract in respect thereof is executed".

EVASION OF SALES TAX

Provision to check evasion of sales tax are within the legislative competence of the States under entry 54, List II. This being so, the provisions to make imposition of tax efficacious, or to prevent evasion of tax, are within the legislative competence of the State Legislature.[49]

Another problem which the legislature has been called upon to tackle in this area is that of unauthorised collection of sales tax by the dealers. When sales tax had been assessed and paid, but in pursuance of the *United Motors case*,[50] a part of it became refundable by the State as no tax could be levied on goods despatched for consumption outside the State, the legislature laid down that the refund could be claimed from the government by the purchaser from whom the dealer had actually collected the tax. This provision, therefore, deprived the as-

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46. For further discussion see *Bharat Sanchar Nigam Ltd v. Union of India* (supra)
47. *Builders Association of India v. Union of India,* AIR 1989 SC 1370 : (1989) 3 SCC 98.
48. *20th Century Finance Corp. Ltd. v. State of Maharashtra,* AIR 2000 SC 2436 : (2000) 6 SCC 12; *Goa Carbon Ltd. v. CTT,* (2008) 11 SCC 176 : (2008) 3 JT 316.
49. *State of Rajasthan v. D.P. Metals,* AIR 2001 SC 3076 : (2002) 1 SCC 279.
50. *Infra*, Sec. J(i).

sessees of the common law right to claim refund of the amounts paid as tax under an error of law.

This was a strategy adopted by the State to refund as little as possible as small consumers could hardly be expected to claim small amounts paid by them as sales tax. The State refused to refund the money to the dealers from whom it had collected. Nevertheless, the law was held valid as being covered by the *incidental* and *ancillary* power[51] relating to the levy and collection of sales tax.[52]

According to the Supreme Court, the various entries denote diverse heads of legislation demarcating the periphery of legislative competence and include all matters which are ancillary or subsidiary to the primary head.[53] The State Legislature is therefore competent to exercise power in respect of the subsidiary or ancillary matter of granting refund of tax improperly or illegally collected. This view was reiterated by the Court in *Burmah Construction*.[54]

A State law authorised the government to recover from any person any amount collected by him as sales tax otherwise than in accordance with the provisions of the relevant law. In substance, the provision meant that whatever had been collected by a dealer as sales tax, even though it was not exigible as tax under the law, had to be paid over to the government. The provision provided for recovery of the amount collected as sales tax even though the amount was not due as tax under the law.

The law was held to be not valid as the State could levy sales tax, but any other collection without the authority of law could not be regarded as sales tax and the State could not recover the same. Such a law did not fall within the 'incidental or ancillary' powers as these can be exercised only in aid of the main topic of *legislation i.e.* sales tax. The Supreme Court observed that there must be a limit to the incidental or ancillary power flowing from the legislative entries in the various lists. The Court refused to accept that "the ambit of ancillary or incidental power goes to the extent of permitting the legislature to provide that though the amount collected—may be wrongly—by way of tax is not exigible under the law as made under the relevant taxing entry, it shall still be paid over to Government, as if it were a tax".

The Court distinguished the provision from that held valid in *Orient Paper.*[55] That provision dealt with the matter of refund of what had already been deposited with the government and the question of refund of a tax collected "is always covered by incidental and ancillary powers relating to levy and collection of tax". But the provision in the instant case required payment to the government of something collected by way of tax, though not really due as a tax under the law enacted under entry 54, List II.[56]

Later, in *Ashoka Marketing*,[57] the Supreme Court declared invalid a provision similar to the one involved in *Abdul Quadir* but which was coupled with a provi-

51. *Supra*, Ch. X, Sec. G(a).
52. *Orient Paper Mills v. State of Orissa,* AIR 1961 SC 1438 : (1962) 1 SCR 549.
53. *Supra*, Ch. X, Sec. G(a).
54. *Burmah Const. Co. v. State of Orissa,* AIR 1962 SC 1320 : 1962 Supp (1) SCR 242.
Also see, *Tripura Goods Transport Association v. Commr. of Taxes,* AIR 1999 SC 719.
55. *Supra*, footnote 52.
56. *Abdul Quader & Co. v. S.T. Officer,* AIR 1964 SC 922 at 922, 923 : (1964) 6 SCR 867.
57. *Ashoka Marketing v. State of Bihar,* AIR 1971 SC 946 : (1970) 1 SCC 354.

sion to refund the amount actually to the person from whom the dealer had collected the amount as tax. The Court observed: "the State has no power to legislate for recovering amount which is collected by the taxpayer in order to recoup himself for payment of tax which under the law he is not bound to pay".

But then to meet the problems, the State changed its strategy. A law was enacted prohibiting collection of sales tax by any one on sale of goods on which no such tax was payable under the law. Unauthorised collection was made punishable with fine and imprisonment and, above all, any unauthorised collection was to be forfeited to the State. The Supreme Court now validated the forfeiture clause in *R.S. Joshi v. Ajit Mills*[58] as imposing a penalty for breach of law and thus falling under entry 54, List II. The earlier cases were distinguished on the ground that there the Legislature had sought to grab the tax money even though not exigible under the law while here a penalty was imposed for infringing the sales tax. As a "punitive measure to protect public interest in the enforcement of the fiscal legislation, it falls squarely within the area of implied power."

The problem presented by *Joshi* was that a dealer had collected tax outside the law and that he should not stand to benefit thereby. The best solution to the problem was to return the amount to those who paid it, but it was not practical to return small amounts to numerous people. The next best solution could be to make the State as the beneficiary, but the State could not collect any tax without the authority of law as was held in the earlier cases. Now a way was found to achieve the same result, *viz.*, to forfeit the money which was conceptually a penal sanction for enforcement of law and was different from collecting tax money. To impose a sanction for enforcement of the sales tax law fell within the scope of entry 54, List II, as an ancillary matter.[59] Thus, a change in phraseology and concept enabled the State to achieve the same result which it had failed to achieve in the earlier cases.

The Orissa Legislature passed a law requiring a dealer collecting sales tax to deposit the same with the government "notwithstanding that the dealer is not liable to pay such amount as tax.' The Government would hold the amount so deposited in trust and would return the same on application. The Act was held valid in *State of Orissa v. Orissa Cement*[60] following *Joshi* 'and overruling *Ashoka Marketing*.[61] The *Orissa* ruling has been reiterated in *Kasturi Lal Harlal v. State of Uttar Pradesh*.[62] The Court ruled that the taking over of sums collected by dealers from the public under guise of tax solely with a view to return the same to the buyers so deprived "is necessarily incidental to 'tax on the sale and purchase of goods'. The Court has further observed:[63]

> "It is now well settled that an entry in a legislative List must be read in its widest amplitude and the legislature must be held to have power not only to legislate with respect to the subject-matter of the entry but also to make ancillary or incidental provision in aid of the main topic of legislation."

Usually, sales tax is passed on by the seller to the buyer. But it is not an essential characteristic of this tax. It is a matter of policy for the legislature whether the

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58. AIR 1977 SC 2279 : (1977) 4 SCC 98.
59. *Supra*, Sec. B.
60. *State of Orissa v. Orissa Cement*, AIR 1986 SC 178 : 1985 Supp SCC 608.
61. *Supra*, footnote 57.
62. AIR 1987 SC 27 : (1986) 4 SCC 704.
63. *Ibid*, at 28.

law should provide for passing on the sales tax to the consumer. When a State levied a surcharge of 10% on the sales tax payable by the dealers, and prohibited the surcharge from being passed on to the purchasers, it was held to be valid under this entry.[64]

CONSIGNMENT TAX

In *Goodyear India Ltd. v. State of Haryana*,[65] the Supreme Court declared invalid what is known as the consignment tax. The Company purchased some raw materials in the State (without paying any sales tax), used the same in the manufacture of tyres and despatched a good portion of the manufactured goods to its several depots outside the State (otherwise than by way of sale) while retaining both title and possession thereof. Under the State law, the purchase of raw materials then became subject to the purchase tax. The Court ruled that in such a situation, the liability to pay tax arises only when the goods are despatched or consigned out of the State and, thus, the tax event was not 'purchase' but 'despatch' of goods outside the State in the course of interstate trade and commerce and such a tax would lie outside the State power to tax.[66] The mere consignment of goods by a manufacturer to his own branches outside the State does not in any way amount to a sale of goods. The Court emphasized that the nomenclature of the tax is not conclusive. To determine the true character and nature of a particular tax, with reference to the legislative competence of a particular legislature, the court looks to its pith and substance. The power to levy consignment tax vests in Parliament in view of Art. 269[67] and Entry 92B, List I.[68]

A tax on "expenditure" has been held to be not a tax on "sale". The expenditure tax does not thus fall under this entry.[69]

55. Taxes on advertisements other than those published in the newspapers.

This would include for example taxes on hoardings. A tax on advertisements published in the newspapers falls under entry 92, List I.[70]

56. Taxes on goods and passengers carried by road or on inland waterways:

See entry 89, List I.[71] This tax is known as terminal tax. A tax on the transport of kendu leaves can be validly levied under this entry as it is a tax on the transport of goods by road.[72]

A tax payable by operators in respect of passengers carried and goods transported by motor vehicles, the tax being measured by the value of fare and freight charged, falls under this entry, as it is a tax on passengers and goods and not on fares and freights although it is measured by fares and freights. It is only on such

64. *Kodar v. State of Kerala,* AIR 1974 SC 2272 : (1974) 4 SCC 422; *Hoechst Pharmaceuticals v. State of Bihar*, AIR 1983 SC 1019, 1047 : (1983) 4 SCC 45.
65. AIR 1990 SC 781. Also see, *Hotel Balaji v. State of Andhra Pradesh,* AIR 1993 SC 1048.
66. See, *infra.* Ch. XV.
Also, entry 92A, List I, Sec. C. *supra.*
67. See, *infra,* Sec. K(a).
68. *Supra,* Sec. C.
69. *Federation of Hotel and Restaurant v. Union of India,* AIR 1990 SC 1637 : (1990) 3 SCC 619.
70. *Supra,* Sec. C.
71. *Supra,* Sec. C.
72. *State of Uttar Pradesh v. Mohanlal Hargovind Das*, (2000) 10 SCC 356.

goods and passengers as are carried by road or on inland waterways that a tax can be levied under this entry. The Court ruled that the incidence of the tax is upon passengers and goods, though the amount of the tax is measured by fares and freights.[73] A levy of service tax on carriage of goods by transport operators is a levy distinct from the levy envisaged under Entry 56.[74] Though incidence of tax is on goods and passengers but law can be enacted to recover the tax from the owners of operators of the vehicle.[75]

The Allahabad High Court has ruled[76] that a tax on passengers under entry 56 must be a tax directly imposed on passengers, though it need not be directly collected by the State from the passengers. In other words, the impact of the tax must be on the passengers. A levy to be valid under this entry is a tax paid by the passengers although it is collected by the State through the agency of the operators who collect the tax as well as the fare from the passengers.[77] The Allahabad High Court has explained the nature of the tax on passengers in these words:

> "A tax on passengers must be a tax directly imposed on passengers, though it need not be directly collected by the State from the passengers. In other words, the impact of the tax must be on passengers."[78]

A tax on goods which enter or leave the municipal limits but having no relation to their transport cannot fall under this entry.[79] Keeping in view the theory that the legislative entries should be interpreted broadly, it has been held that a State can validly levy a tax on goods carried and make it payable by the producer of goods instead of the carrier.[80] The competence of the States to tax goods carried is not affected whether the goods are carried for a long or short distance. It is the physical carriage of goods through a State which is the taxing event.

Levy of terminal tax on goods meant for destination beyond Delhi but passing through Delhi is not invalid. In the instant case,[81] there were two separate transactions, one by which the goods were meant for Delhi, and the other by which after having reached and having been unloaded at Delhi, the goods were rebooked and reloaded for some other destination and this, therefore, was a fresh and different transaction. In such a case, terminal tax would be leviable at the entry point in the territory of Delhi. The Delhi Municipal Corporation levied a terminal tax on goods and animals carried by road which were imported into, or exported from, the municipal limits. The tax was held valid under entry 56, List II.[82]

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73. *Sainik Motors v. State of Rajasthan*, AIR 1961 SC 1480; *A.S. Karthikeyan v. State of Kerala*, AIR 1974 SC 436 : (1974) 1 SCC 258. See also *State of H.P. v. Yash Pal Garg*, (2003) 9 SCC 92 : (2003) 4 JT 413; *State of Gujarat v. Akhil Gujarat Pravasi V.S. Mahamandal,* (2004) 5 SCC 155 : AIR 2004 SC 3894.

74. *Gujarat Ambuja Cements Ltd. v. Union of India*, (2005) 4 SCC 214, at page 228.

75. *State of Gujarat v. Akhil Gujarat Pravasi* (2004) 5 SCC 155 : AIR 2004 SC 3894.

76. *Jagdish Prasad v. Passenger Tax Officer, Mathura*, AIR 2000 All 205 (FB).

77. Also see, *A.S. Karthikeyan v. State of Kerala*, AIR 1974 SC 436 : (1974) 1 SCC 258.

78. *Jagdish Prasad, supra*, footnote 76, at. 208.
Also see, *A.S. Karthikeyan v. State of Kerala*, AIR 1974 SC 436 : (1974) 1 SCC 258.

79. *Achalpur Municipality v. Nandkishore*, AIR 1967 Bom 413.

80. *Khyerbari Tea Co. v. Assam*, AIR 1964 SC 925 : (1964) 5 SCR 975.
See also, *infra*, under Freedom of Trade, Commerce and Intercourse, Ch. XV.

81. *Man Mohan Tuli v. Delhi Municipal Corp.*, AIR 1981 SC 991.

82. *Monju Kalyanji v. State of M.P.*, AIR 1988 MP 220; *Meera Khandelwal v. State of Madhya Pradesh,*, AIR 1997 MP 163.

Under entry 56, List II, a State can levy a tax on passengers and goods carried on national highways.[83] This entry does not exclude national highways and national waterways.[84] Entry 56 uses the terms 'road' and 'inland waterways'. So "national highways and "national waterways" (so declared under entries 23 and 27, List I) are not exempted from the scope of entry 56. Thus, taxes on passengers and goods carried on national highways fall directly and squarely within entry 56.[85]

However, under this entry, a State could only impose a tax of a 'compensatory' and 'regulatory' nature.[86] A State incurs considerable expenditure in connection with national highways (though the primary responsibility for them rests on the Centre) not directly by constructing or maintaining them but by facilitating the transport of goods and passengers along them in various ways such as lighting, traffic control, amenities for passengers, halting places for buses and trucks, etc.[87] This constitutes sufficient nexus between the tax and the passengers and goods carried on the national highways to justify the State imposition of tax thereon.[88]

57. Taxes on Vehicles, whether mechanically propelled or not, suitable for use on roads, including tramcars subject to the provisions of entry 35, List III[89]

This entry empowers legislation in respect of taxes on vehicles, whether mechanically propelled or not. The Supreme Court has stated in *Bolani*[90] that the power exercisable under this entry "is the power to impose taxes which are in the nature of regulatory and compensatory measures".[91]

In *Jayaram,*[92] the Supreme Court has observed: "By virtue of the power given to them by entries 56 and 57 of List II every one of the States has the right to make its own legislation to compensate it for the services, benefits and facilities provided by it for motor vehicles operating within the territory of the State. Taxes resulting from such legislative activity are by their very nature and nativity, cast and character, regulatory and compensatory and are, therefore, not within the vista of Art. 301, unless…. the tax is a mere pretext designed to injure the freedom of inter-state trade, commerce and intercourse".

The regulatory and compensatory nature of the tax is that the taxing power should be exercised to impose taxes on motor vehicles which use the roads in the State, or are kept for use thereon either throughout the whole area or parts

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83. Under the National Highways Act, 1956, certain highways have been declared as national except such parts thereof as lie within any municipal area. See entry 23, List I, *supra*.

84. Entry 24, List I, *supra*, Ch. X, Sec. D.

85. *International Tourist Corporation v. State of Haryana,* AIR 1981 SC 774 : (1981) 2 SCC 318.

86. For discussion on the concept of a "compensatory" or "regulatory" tax, see, *infra*, Ch. XV.

87. *International Tourist Corporation v. State of Haryana*, AIR 1981 SC 774; *Manmohan Vig v. State of Haryana*, AIR 1981 SC 1035 : (1981) 2 SCC 334.

88. *Supra*, Ch. X, Sec. A.

89. *Infra*, Sec. E.

90. *Bolani Ores Ltd. v. State of Orissa,* AIR 1975 SC 17 : (1974) 2 SCC 777.

91. *Ibid,* 22. For discussion on the expression "regulatory and compensatory" taxes, see, *infra,* Ch. XV.

92. *B.A. Jayaram v. Union of India*, AIR 1983 SC 1005.

thereof and are sufficient to make and maintain such roads.[1] The power of taxation under this entry "cannot exceed the compensatory nature which must have some nexus with the vehicles using the roads, *viz.*, public roads". This means that if vehicles do not use the roads notwithstanding that they are registered, they cannot be taxed.[2] The condition that a tax under this entry should be 'regulatory and compensatory' in nature comes in from Art. 301, discussed later.[3]

The power to impose penalty was upheld as being incidental to the main purpose of regulation in *State of U.P. v. Sukhpal Singh Bal*.[4]

For purposes of taxation, the vehicles in question must be "suitable for use on the roads"; No tax can be levied on vehicles which are not suitable for use on the roads. This means that entry 57 only refers to vehicles "which are reasonably suitable for the road in the sense that an average man could think that plying of the vehicles on the road would be one of the normal uses of the vehicles".[5] Dumpers, rockers and tractors are suitable for use on the roads.[6] Truck chassis, two wheeler scooters, motorcycles, or a three wheeler autorickshaw are all adapted for use on roads. In fact, these vehicles are really meant for use upon roads. Hence all these vehicles are taxable under this entry.[7]

On the question of interpretation of the words "suitable for use on roads" in the entry, the Supreme Court has observed in the *Automobile Transport* case:[8]

> "The words "suitable for use on roads" describe the kinds of vehicle and not their condition. They exclude from the Entry, farm machinery, aeroplanes, railways etc. which though mechanically propelled are not suitable for use on roads.".

Bihar levied a tax at an annual rate on a manufacturer or a dealer in motor vehicles in respect of motor vehicles in his possession as such manufacture or dealer. Telco manufactured chassis and kept them within the factory premises. Telco argued that the tax did not fall within entry 57. The High Court ruled the tax to be valid. The chassis were suitable for use on roads. They were, in fact, manufactured for use on roads. Since the vehicles were meant to be used on roads maintained by the State at its cost, the tax did have a compensatory character.[9]

A tax on motor vehicles on the basis of their seating capacities has been held valid under this entry.[10]

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1. *The Automobile Transport (Rajasthan) Ltd. v. State of Rajasthan,* AIR 1962 SC 1406 : 1963 (1) SCR 491.

2. *Bolani, supra,* footnote 90 at 28.
Also, *G.K. Krishnan v. State of Tamil Nadu,* AIR 1975 SC 583 : (1975) 1 SCC 375; *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. See also *Southern Petrochemical Industries Co. Ltd. v. Electricity Inspector & ETIO,* (2007) 5 SCC 447 : AIR 2007 SC 1984.

3. *Infra,* Ch. XV.

4. (2005) 7 SCC 615, at page 622 : AIR 2005 SC 3324.

5. *Bolani, supra,* at 23.

6. *Ibid* at 26.
Also, *Central Coal Fields Ltd. v. State of Orissa,* AIR 1992 SC 1371 : 1992 Supp (3) SCC 133.

7. *Tata Engineering and Locomotive Co. Ltd. v. State of Bihar,* AIR 1999 Pat. 62.

8. *Supra,* footnote 1, at 1438.

9. *Supra,* footnote 52.

10. *Malwa Bus Service (Pvt.) Ltd. v. State of Punjab,* AIR 1983 SC 634 : (1983) 3 SCC 237; *East Bihar Regional Bus Union v. State of Bihar,* AIR 1998 Pat. 152.

A "lifetime tax" leviable in lump sum in advance for the lifetime of a motor vehicle (four-wheeler) on the basis of the index of "weight-cum-value" has also been held to be valid.[11]

There was a difference of opinion among the High Courts on one aspect of taxation under entry 57. According to Patna High Court tax could be levied on vehicles which are suitable tobe used on the road whether or not it is actually used on the road. The expression "suitable for use on the roads" establishes the nexus between the motor vehicles and the roads which are maintained by the State.[12] On the other hand, the Gujarat High Court took a narrower view of the matter. The court ruled that the tax is not levied on ownership or possession of the motor vehicle. If the vehicle is not used, its owner can claim refund of that tax paid by him in advance. Taxation on motor vehicles can be compensatory only. This means that the State cannot impose tax on 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.[13] The view of Gujarat High Court must be taken to be overruled by the Supreme Court which held in *State of Gujarat v. Akhil Gujarat Pravasi V.S. Mahamandal*,[14] that a tax under this entry is a tax and not a fee and that the actual use of the public roads of the State cannot be insisted upon for incurring the liability.

A State tax was levied on all motor vehicles 'used or kept for use in the State'. The Supreme Court interpreting this as 'used or kept for use on the public roads of the State' held it valid under this entry as it authorises levy on vehicles suitable for use on roads.

58. Taxes on animals and boats

A State tax on mechanically propelled barges has been upheld as falling under this entry. The State can tax all kinds of boats. Under this entry, barges belong to the family of boats and not ships. There is no reason to confine the term "boats" in this entry to boats which are exclusively propelled by oars.[15]

Entries 24, 25 and 27 in List I,[16] and entries 31 and 32 in List III[17], operate in their own fields and do not entrench upon the subject covered by entry 58, List II.

59. Tolls

Toll is a payment realised for some service, amenity, advantage or benefit, *e.g.*, for the use of a market or bridge or a road.[18]

A State Government is authorised to levy toll under s. 2 of the Indian Tolls Act, 1851. Toll may be levied upon any road or bridge made or repaired at the expense of the Central or the State Government. "For advantage obtained by the

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11. *State of T.N. v. M. Krishnappan*, (2005) 4 SCC 53 : AIR 2005 SC 2168.
12. *Tata Engineering, supra*, AIR 1999 Pat. 62.
13. *Kaushikbhai K. Patel v. State of Gujarat*, AIR 1999 Guj. 84.
14. (2004) 5 SCC 155, at page 166 : AIR 2004 SC 3894. See also *Jai Prakash v. State of U.P.*, (2004) 13 SCC 390, 398.
15. *Panduronga Timblo Industries v. Union of India*, AIR 1992 SC 1194 : (1992) 2 SCC 635.
16. *Supra*, Ch. X, Sec. D.
17. *Supra*, Ch. X, Sec. F.
18. *P.L. & Lime Stone Co. v. Cantt. Board*, AIR 1967 All. 15.

public by the construction of the roads or bridges, the State Government is entitled to reimburse itself for providing the service". The rate of toll must bear a reasonable relationship to the providing of the benefit.[19]

60. Taxes on professions, trades, callings and employment

A tax under the present entry may be imposed on professions, employments including service, and on trades or callings.[20] A tax on pension is a tax on income and not on profession as being a pensioner is not a profession or employment, and so falls outside entry 60.[21]

A tax may be imposed on the subject-matter of the trade, *e.g.*, on each bale of ginned cotton,[22] or on the income arising from trade or profession.[23] But Entry 60 which refers to professions cannot be extended to include services which are taxable exclusively by Parliament.[24] It may be levied on a corporation, company, an artificial person or a natural person. The tax may be in the nature of a licence fee for a trade, or may be determined by the total business turnover even though there is no income.[25]

Taxes on professions, trades, calling and employments flow from Entry 60. Art. 276(1) only clarifies that levy on such tax is not invalid on the ground that it would relates to tax on income. Such power includes power to determine persons who are liable and rate at which tax is to be paid.[26]

The tax may even be of a graduated type, being measured by income derived from a profession and payable only if there is income. Such a tax is very similar to a tax on income which falls in the Union List. The Constitution recognises this overlapping and, to preserve the State power, Art. 276(1) declares that a tax on professions, *etc*., shall not be invalid on the ground that it relates to a tax on income. Conversely, Art. 276(3) makes it clear that the State power to impose taxes on professions, *etc*., does not limit in any way the power of Parliament to make laws with respect to taxes on income accruing from or arising out of professions, trades, callings and employments.

The idea underlying Arts. 276(1) and (2) is that the State power to levy tax on professions *etc*. is not invalid on the ground that it is a tax on income leviable by Parliament; nor is Parliament's power to levy income tax limited by States' power to levy a profession tax. However, to mitigate the evils arising from an overlapping of Central-State taxes on income, Art. 276(2) lays down that the total amount payable by one person to the State *or* to any one municipality in the State by way of taxes on professions, *etc*. "shall not exceed two thousand and five hundred rupees per annum".

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19. *State of Uttar Pradesh v. Devi Dayal Singh*, (2000) 3 SCC 5 : AIR 2000 SC 961.
20. *Shivananjundappa v. State of Karnataka*, (1993) 2 MPWN 222; *High Court of M.P. Employees' Union v. State of Madhya Pradesh*, AIR 1997 MP 155.
21. *Rajgopalachari v. Corporation of Madras*, AIR 1964 SC 1174.
22. *Bharat Kala Bhandar v. Dhamangaon Municipality*, AIR 1966 SC 249 : (1965) 3 SCR 499; *B.M. Lakhani v. Malkapur Municipality*, AIR 1970 SC 1005.
23. *W.U.P. Electric Power Co. v. Town Area*, AIR 1957 All. 433.
24. *All-India Federation of Tax Practitioners v. Union of India*, (2007) 7 SCC 527, at page 535 : AIR 2007 SC 2990.
25. *Hira Lal Ram Kumar v. S.A. Panchayat*, AIR 1964 Cal. 590.
26. *Karnataka Bank Ltd. v. State of Andhra Pradesh*, (2008) 2 SCC 254 : (2008) 1 SCALE 660.

It is a condition for the validity of this tax that the imposition does not exceed the maximum amount of Rs. 2500.[27] The Supreme Court has held in *Kamta Prasad v. Executive Officer*[28] that under Art. 276(2), the State as well as a municipality can separately levy a profession tax up to the maximum amount each on a person. The word 'or' between the 'State' and 'any municipality' is used disjunctively and not 'conjunctively'.

The State can validly levy profession tax on a person running a nursing home or a hospital.[29]

The validity of the 'circumstances and property tax' levied by a district board in Uttar Pradesh was challenged on several grounds, *e.g.*, it was a tax on professions, trades, callings and employments and, therefore, levied under Art. 276(2); that the tax was income-tax, and so belonged to Parliament. The Supreme Court rejected these arguments in *R.R. Engineering Co. v. Zila Parishad, Bareilly*.[30] The tax was upheld as a tax not on income but on a man's financial position, his status as a whole, depending on his income from trade or business. The tax was referable to entries 49 and 60 in List II,[31] as well as to entry 58.[32] The tax was a composite one, one of its components being the assessee's circumstances by which it meant his financial position, his status as a whole, which depends, *inter alia*, on his income from his lands and buildings and from his trade or calling. The Court observed in this connection:

> "The fact that the tax on circumstances and property is often levied on calling or property is not conclusive of the nature of the tax; it is only as a matter of convenience that income is adopted as a yardstick or measure for assessing the tax. The measure of the tax is not a true test of the nature of the tax. Considering the pith and substance of the tax, if falls in the category of a tax on a man's financial position, his status taken as a whole and includes what may not be properly comprised under the term 'property' and at the same time ought not to escape assessment".

The Court, however, warned that one of the components of the tax, namely, 'circumstances' itself had components referable to other entries in addition to entry 60, and it should not be construed as conferring an unlimited power on the local authorities to impose disproportionately excessive levies on the assessees. An excessive levy on 'circumstances' would tend to blur the distinction between a tax on 'income' and a tax on 'circumstances'. "Income will then cease to be a mere measure or yardstick of the tax and will become the very subject-matter of the tax."

The Court emphasized that one must have regard to the substance of the matter and not to the form or label. This pronouncement made it possible for the States to by-pass the limit imposed by Art. 276(2) on tax leviable under entry 60. However, a recent pronouncement of the law on the subject in *Karnataka Bank Ltd. v.*

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27. *Bharat Kala Bhandar v. Municipal Committee,* AIR 1966 SC 249 : (1965) 3 SCR 499; *Lakhani v. Malkapur Municipality,* AIR 1970 SC 1002; *Akot Municipality v. Manilal,* AIR 1967 SC 1201 : (1967) 2 SCR 100. *Karnataka Bank Ltd. v. State of A.P.,* (2008) 2 SCC 254 : (2008) 1 SCALE 660

28. AIR 1974 SC 685. Also see, *Agra Municipality v. A.B.K.O. Association,* AIR 1976 SC 160.

29. *Dr. Sathurs Sushrushalaya Nursing Home v. State of Karnataka,* AIR 1992 Kant. 274.

30. AIR 1980 SC 1088 : (1980) 3 SCC 330.

31. *Supra*.

32. *Supra*.

State of A.P.,[33] would appear to indicate a reversion to the law as earlier propounded that a State Legislature is precluded by Art. 276 from making laws enabling the authorities to impose tax on professions, trades, callings, etc. in excess of the amount prescribed by Parliament.

61. Capitation Tax:

It is a tax levied on each head or person.

62. Taxes on luxuries including taxes on entertainments, amusements, betting and gambling

The view that this entry contemplates luxuries, entertainments and amusements as objects on which the tax is to be imposed has been discarded.[34] In *Godfrey Phillips India Ltd. v. State of U.P.*,[35] it was held that the word "luxuries" in Entry 62 of List II means the activity of enjoyment of or indulgence in that which is costly or which is generally recognised as being beyond the necessary requirements of an average member of society and not articles of luxury including tobacco.

A tax levied by a State on cinema shows is a tax under this entry and not under entry 60. An entertainment tax is dependent upon whether there would or would not be a show in a cinema house. If there is no show, there is no tax. It cannot be regarded as a tax on profession or calling as profession tax does not depend on the exercise of one's profession but only concerns itself with the right to practice.

The words 'entertainments' and 'amusements' are wide enough to include theatres, dramatic performances, cinemas, sports and the like.[36] The entry envisages a tax on the act of entertaining and it may be levied on the giver or the receiver of an entertainment or on both. A tax levied on each show in a cinema house falls under this entry.[37] A tax levied on cinema shows at prescribed rates in a rising scale according to the seating accommodation and the cities where the shows are held has been held to be valid.[38]

A tax was levied on the basis of the percentage of the gross collection capacity per show. Different percentages were prescribed depending on the type of the theatre and the nature of the local area where it was situated. The tax was held valid under this entry.[39] The Supreme Court has ruled that tax on entertainment can be levied by either of the two modes, *viz.*, per payment of admission or gross collection capacity per show and it is for the legislature to decide which mode to adopt.

A person wishing to see a film in a drive-in cinema sitting in his car was required to pay Rs. 2/- more in addition to a tax on his admission to the cinema.

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33. (2008) 2 SCC 254, at page 266 : (2008) 1 SCALE 660.

34. *Western India Theatres v. Cantonment Board*, AIR 1959 SC 582 : 1959 Supp (2) SCR 63.

35. (2005) 2 SCC 515, at page 540 : AIR 2005 SC 1103; See also *State of W.B. v. Purvi Communication (P.) Ltd.*, (2005) 3 SCC 711 : AIR 2005 SC 1849; *Ghodawat Pan Masala Products (I) Ltd. v. State of Maharashtra*, (2005) 4 SCC 415 : AIR 2005 SC 2909.

36. *Corporation of Calcutta v. Liberty Cinema*, AIR 1965 SC 1107 : (1965) 2 SCR 477.

37. *Western India Theatres v. Cantonment Board*, AIR 1959 SC 582 : 1959 Supp (2) SCR 63; *Delite Talkies v. Jabalpur Corporation*, AIR 1966 MP 299.

38. *Y.V. Srinivasamurthy v. State of Mysore*, AIR 1959 SC 894 : 1957 SCR 874.

39. *Venkateshwara Theatre v. State of Andhra Pradesh*, AIR 1993 SC 1947.

The tax was held valid by the Supreme Court. Applying the principle of pith and substance, the Court ruled that the impugned tax was not a tax on car but on entertainment falling under entry 62, List II. The incidence of the tax was entertainment. Since entertainment necessarily implies the persons entertained, therefore, the incidence of the tax falls on persons entertained. The levy in question was not on the car but on the person being entertained sitting in his car. The word 'entertainment' in entry 62 is wide enough to comprehend within itself the luxury or comfort with which a person entertains himself.[40]

A tax levied on a percentage basis on sums received by way of entry fees by the promoters of a lottery or prize competition of a gambling nature is a tax on betting and gambling under this entry and not a tax on trade or profession under entry 60.[41]

A tax on a wagering contract may fall within this entry. When two parties enter into a contract for sale or purchase of goods at a given price, and for their delivery at a given time, and if they intend not an actual transfer of goods but only to receive the difference according as the market price should vary from the contract price, then it is a wager on the rise or fall of the market which comes within the connotation of gambling.

A tax on forward contracts without reference to the intention of the parties not to take delivery of goods at all would not fall under this entry.[42] A luxury tax can be imposed on tobacco as an item of luxury. Such a tax is not invalid even though an excise tax is levied on tobacco by the Centre.[43]

An expenditure tax levied *ad valorem* on "chargeable expenditure" incurred in hotels where the room tariff for a unit of residential accommodation was Rs. 400/- per person per day has been held to be not a tax on "luxuries". It is a tax on 'chargeable expenditure' incurred by a person in such hotels. Such a tax does not fall under this entry, as it is a tax on "expenditure" and not on "luxuries".[44]

A State tax on lodging charges in hotels has been held to be valid as a tax on "luxuries". In accordance with the principle that each entry should be given its "fullest meaning and widest scope",[45] the expression "luxuries" in this entry has been broadly interpreted. The Supreme Court has ruled: "The concept of a tax on 'luxuries' in entry 62, List II cannot be limited merely to tax things tangible and corporeal in their aspect as 'luxuries'. "The entry encompasses all the manifestations or emanations, the notion of 'luxuries' can fairly and reasonably be said to comprehend" and that "the element of extravagance or indulgence that differentiates "luxury" from "necessity" cannot be confined to goods and articles. There can be elements of extravagance or indulgence in the quality of services and activities."[46]

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40. *State of Karnataka v. Drive-in-Enterprises*, AIR 2001 SC 1328 : (2001) 4 SCC 60.

41. *State of Bombay v. R.M.D. Chamarbaugwala*, AIR 1957 SC 699 : 1957 SCR 874.

42. *Bullion & Grain Exchange Ltd. v. State of Punjab*, AIR 1961 SC 268 : (1961) 1 SCR 668.

43. *Kaitha Kutta v. Board of Revenue*, AIR 1966 Ker 46.

44. *Federation of Hotel & Restaurant v. Union of India*, AIR 1990 SC 1637 : (1989) 3 SCC 634.

45. See, *supra*, Ch. X, Sec. G(a); Ch. XI, Sec. B, *supra*.

46. *Express Hotels Pvt. Ltd. v. State of Gujarat*, AIR 1989 SC 1949 : (1989) 3 SCC 677.
Also see, *Western India Theatres Ltd. v. Cantonment Board, Poona Cantonment*, AIR 1959 SC 582 : 1959 Supp (2) SCR 63; *A B Abdul Kadir v. State of Kerala*, AIR 1976 SC 182 : (1976) 3 SCC 219; *Ramanshree Shopping Arcade Pvt. Ltd. v. State of Karnataka*, AIR 2000 Kant 33.

63. Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty :

See entry 91 of List I.[47]

The State Legislature may provide for the rates of stamp duty in respect of documents other than those specified in provisions of List I under this entry. Thus the levy and prescription of rates of stamp duty under the Bombay Stamp Act, 1958 on an order of amalgamation passed under Section 394 of the Companies Act, 1956 is constitutional.[48] A provision for pre-deposit pending determination of the market value of property and the proper duty payable, is traceable to this Entry read with Entry 44 of List III as such provisions are for plugging loopholes and for quick realisation of the stamp duty.[49]

66. Fees in respect of any of the matters in this List, but not including fees taken in any court.

Court-fees fall under entry 3 of the List[50] as also market fees in respect of sale and purchase of tobacco within the market area.[51] In State of W.B. v. Kesoram Industries Ltd it was held that cesses levied on coal-bearing land and on tea plantation land could be upheld by reference to Entry 66 read with Entry 5 of List II.[52]

E. CONCURRENT TAXES

The Concurrent List has only a few tax entries, *viz.*—

35. Principles on which taxes on mechanically propelled vehicles are to be levied

Under this entry, Parliament as well as the State Legislatures can legislate to lay down principles of taxation in respect of only the mechanically propelled vehicles. Legislation under this entry cannot be made in respect of vehicles which are not mechanically propelled. On the other hand, under entry 57, List II,[53] the States can impose tax on all kinds of vehicles—mechanically propelled or not.

The two entries, *viz.*, 57 in List II and 35 in List III, deal with two different matters though allied ones—one with taxes on vehicles and the other with the principles subject to which such taxes are to be levied. "Taxes on vehicles in their ordinary meaning connote the liability to pay taxes at the rates at which the taxes are to be levied." On the other hand, the expression 'principles of taxation' denotes the rules of guidance in the matter of taxation.

Explaining the relation between entry 57, List II, and entry 35, List III, the Supreme Court has observed in *Jayaram*[54] that the power to levy taxes on vehicles

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47. See, *supra*, Sec. C.
48. *Hindustan Lever v. State of Maharashtra* ,(2004) 9 SCC 438 : AIR 2004 SC 326.
49. *Govt. of A.P. v. P. Laxmi Devi*, (2008) 4 SCC 720 : AIR 2008 SC 1640.
50. *Supra*, Ch. X, Sec. E; see, *infra*, Sec. H.
51. *ITC Ltd. v. Agricultural Produce Market Committee,* (2002) 9 SCC 232 : AIR 2002 SC 852, overruling *ITC Ltd. v. State of Karnataka*, 1985 Supp (1) SCR 145
52. (2004) 10 SCC 201 : AIR 2005 SC 1646; See also *Vijayalashmi Rice Mill v. CTO,* (2006) 6 SCC 763, at page 767 : AIR 2006 SC 2897.
53. *Supra*, Sec. D.
54. *B.A. Jayaram v. Union of India*, AIR 1983 SC 1005 : (1984) 1 SCC 168.

vests solely in the State Legislature, but Parliament may lay down the principles on which taxes may be levied on mechanically propelled vehicles.[55] "In other words, Parliament may lay down the guidelines for the levy of taxes on mechanically propelled vehicles but the right to levy such taxes vests solely in the State Legislature."

Thus, under this entry, only 'principles' for taxation can be laid down; no tax, as such, can be levied. Entry 35, List III, does not confer power to tax but only connotes rules of guidance in the matter of taxation. It is open to Parliament to lay down the principles on which taxes may be levied on mechanically propelled vehicles. So far Parliament has not enacted any law regulating the principles of taxation, or the rules for the guidance of taxation on motor vehicles. The Motor Vehicles Act is only a regulatory measure and does not in any way affect or control the power of the States under entry 57, List II.[56]

The States can levy taxes on mechanically propelled vehicles under entry 57, List II.[57] Thus, each State has the right to make its own law to compensate it for the services, benefits and facilities provided by it for motor vehicles operating within its territory. These taxes have, however, to be regulatory and compensatory in nature.[58]

There are 28 States and 7 Union Territories. As each of them has a right to levy tax on motor vehicles, there may be great difficulties in the way of evolving All-India permits. If a bus has to pay a tax to each State through which it passes, it will impose a heavy burden on inter-State tourist traffic. To overcome such difficulties, and to introduce uniformity of taxation throughout the country, the Centre has been authorised, under entry 35, List III, to lay down principles on which taxes on mechanically propelled vehicles may be levied by the States under entry 57, List II.

44. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty:

Rates of stamp duties are fixed by Parliament under entry 91, List I[59] on such documents as bills of exchange cheques and debentures etc. Stamp duties in respect of documents not specified in entry 91, List I, are to be fixed by the State Legislatures under entry 63, List II.[60]

A State Legislature can levy stamp duty on the certificate of enrolment of an advocate under this entry read with entry 63 of List II.[61]

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55. *State of Assam v. Labanya Probha Debi*, AIR 1967 SC 1575 : (1967) 3 SCR 611.

56. *Indian Telephone Industries Ltd. v. State of Karnataka*, AIR 1985 Kant 186; *Sharma Transport v. Govt. of Andhra Pradesh*, AIR 2002 SC 322 : (2002) 2 SCC 188. The view expressed in *M.P. AIT Permit Owners Assn. v. State of M.P.*, (2004) 1 SCC 320, at page 327 : AIR 2004 SC 981 that the State cannot provide for additional punishment for the same offence arising under Section 66 read with Section 192-A of the MV Act was differed from in *Hardev Motor Transport v. State of M.P.*, (2006) 8 SCC 613 : AIR 2007 SC 839.

57. *Supra*, Sec. D.

58. *Infra*, Ch. XV; *supra*, Sec. D.

59. *Supra*, Sec. C.

60. *Supra*, Sec. D.

61. *Bar Council, U.P. v. State of Uttar Pradesh*, AIR 1973 SC 231 : (1973) 1 SCC 261; *Hindustan Lever v. State of Maharashtra*, (2004) 9 SCC 438, at page 446 : AIR 2004 SC 326 supra, Sec. D.

47. Fees in respect of any of the matters in this List, but not including fees taken in any court

In *T.N. Godavarman Thirumulpad (87) v. Union of India*,[62] a "Compensatory Afforestation Fund" created by notification of the Ministry of Environment and Forests was held to be referable to this Entry read with Entry 20 of List III.

For discussion on the concept of fee, as distinguished from a tax, see, Sec. H, *infra*.

CONTINUANCE OF STATE TAXING POWER

Article 277 permits continuance of a tax being levied by a State, or a local body, at the commencement of the Constitution in spite of the fact that such a tax falls in the Union List.

The tax may be levied and applied to the same purposes till Parliament makes a law to the contrary. Only the existing range of the taxes is protected and not the expansion of the range of taxation by subjecting new items to it, or by increasing the rates of the tax, or altering is incidence.[63]

The provision seeks to protect the finances of the States and the municipalities from being dislocated by a sudden discontinuance of those taxes which they had been levying earlier, but could no longer levy after the Constitution because these have been allotted to the Centre.

F. NO TAX OUTSIDE THE TAX ENTRIES

Entries 1 to 81 in List I mention the several matters on which Parliament could legislate and entries 82 to 92A, List I enumerate the taxes which Parliament could impose.[64] While the main subject of legislation is included in the first group (1-81), a tax in relation thereto is separately mentioned in the second group (81-92A). Thus, entry 22 in List I deals with Railways, while entry 89 deals with terminal taxes on goods or passengers carried by Railways; entry 41 deals with import and export, and entry 83 with duties of customs; entries 43 and 44 deal with the incorporation and regulation of companies while entry 85 deals separately with corporation tax.

Similarly in List II, entries 1 to 44, form a group comprising the subjects on which States can legislate; entries 45 to 63 deal with taxes. For example, entry 18 is 'land' while entry 45 is 'land revenue'.

From the above, it is clear that taxation is not included in the main subject in which it might, on an extended construction, be regarded as included, but is treated as a distinct matter for purposes of legislative competence. A tax cannot, therefore, be levied outside the specific tax entries enumerated in the three Lists. A tax can be levied only under a 'tax' entry and not under a 'non-tax' entry as an

62. (2006) 1 SCC 1, at page 14 : AIR 2005 SC 4256.
63. *Amraoti Municipality v. Ramchandra*, AIR 1964 SC 1166 : (1964) 6 SCR 947; *Firm Surajmal Bansidhar v. Ganganagar Municipality*, AIR 1979 SC 246 : (1979) 1 SCC 303.
64. See, *supra*, Sec. C.

ancillary or incidental matter.[65] Therefore, Parliament's power in respect of inter-State trade and commerce under entry 42, List I, could not be read as including tax on inter-State sales.[66] Similarly, though entry 18, List II, mentions the subject of transfer and alienation of land, it does not include taxation on transfers and alienation of land.[67]

The Mysore Legislature passed a resolution under Art. 252 conferring on Parliament the power to make law in regard to control and regulation of prize puzzle competitions[68] and all matters incidental thereto. Later the Legislature levied a tax on prize competitions. The tax was challenged on the ground that the Legislature had surrendered all its legislative power in regard to prize competitions including the power to tax.

The Supreme Court held that the subject of 'betting and gambling' (entry 34)[69] and the taxes thereon (entry 62)[70] are separate powers, and when control of prize competitions was surrendered to Parliament by the resolution, the power to tax was not surrendered.[71]

As stated earlier,[72] a general legislative entry does not support levy of a tax. For purposes of State taxation, reference is to be made to taxing entries (entries 45 to 63) and not to entries 1 to 44, List II, which support general legislation of a non-taxing nature.[73]

In *Synthetics & Chemicals Ltd. v. State of Uttar Pradesh,*[74] the Supreme Court has decided another significant question, *viz.:* can the States levy vend fee or duties in respect of industrial alcohol not fit for human consumption? The States have power to regulate the use of alcohol under entry 8, List II. But the Supreme Court has ruled that in the garb of regulation, a State cannot enact a law which is, in pith and substance,[75] fee or levy which has no connection with the cost of expenses for administering the regulation. The levies in question in the instant case were held as not constituting a part of the regulatory measures.

The Supreme Court has further held that under entry 84, List I, all duties of excise save the ones excepted specifically in entry 84, List I, are generally within the taxing power of Parliament. The power of the State Legislatures to levy duties of excise is circumscribed under entry 51, List II. Entry 8, List II, cannot support a tax. Thus, a State law levying a tax or charge or impost on industrial alcohol, *i.e.,* alcohol used and usable for industrial purposes, is unconstitutional.

The State Legislature has no authority to levy duty or tax on alcohol which is not fit for human consumption as that could only be levied by the Centre. This

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65. *Abdul Quader & Co. v. S.T.O.,* AIR 1964 SC 922 : (1964) 6 SCR 867; *Synthetics & Chemicals Ltd. v. State of Uttar Pradesh,* AIR 1990 SC 1927 : (1990) 1 SCC 109. See also *Shree Digvijay Cement Co. Ltd. v. Union of India,* (2003) 2 SCC 614 : AIR 2003 SC 767.
66. *M.P.V. Sundaramier & Co. v. State of Andhra Pradesh,* AIR 1958 SC 468 : 1958 SCR 1422.
67. *Gaindi v. Union of India,* AIR 1965 Punj. 65.
68. *Supra*, Ch. X, Sec. J.
69. *Supra*, Ch. X, Sec. E.
70. *Supra*, Sec. D.
71. *R.M.D.C. v. State of Mysore,* AIR 1962 SC 594 : (1962) 3 SCR 230; *supra,* Sec. J.
72. *Supra.*
73. *Supra*, Ch. X, Sec. E.
74. AIR 1990 SC 1927 : (1990) 1 SCC 109.
75. For discussion on the Rule of 'Pith and Substance', see, *supra,* Ch. X, Sec. G(d).

decision overrules the earlier decision by the Court in *State of Uttar Pradesh v. Synthetics & Chemicals Ltd.*[76]

G. RESIDUARY TAXES

Entry 97 in the Union List runs thus:

> "Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists."

This entry is further reinforced by Art. 248 which vests in Parliament "exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or the State List." This includes the power to levy residuary taxes along with residuary powers of legislation.

Several taxes have been enacted by Parliament under the residuary entry. The annual deposit scheme has been held to fall under this head. The scheme envisages borrowing of money by the Central Government from the tax-payers in higher income group which is then repaid to them in instalments.[77]

Gift tax falls under the residuary entry. It is not a tax on lands and buildings as units of taxation and so it does not fall under entry 49, List II.[78] What is taxed is the transmission of title by gift, and the value of the land and building is only the measure of the value of the gift. As entry 49 of List II contemplates "a tax directly levied by reason of the general ownership of lands and buildings, it cannot include the gift tax as levied by Parliament". There being no other entry covering a gift tax, it could be levied under the residuary powers of Parliament.[79] An interesting aspect of this case is the formulation of the scope of the residuary entry in the following words:

> "If, however, no entry in any of the three lists covers it, then it must be regarded as a matter not enumerated in any of the three lists. Then it belongs exclusively to Parliament under Entry 97 of the Union List as a topic of legislation."

The expenditure tax also falls in the residuary entry as there is no entry in any List under which it can fall.[80]

In the *Diamond Sugar Mills case*[81] levy of cess on sugarcane by the States was held invalid by the Supreme Court as not falling under Entry 52, List II. [82] As a consequence, the States were faced with the prospect of refunding huge amounts of money collected by them as such cess. To protect the States from refunding the amount collected through the cess, Parliament enacted an Act levying the cess retrospectively and authorising the States to collect the same on its behalf.

In *Jaora Sugar Mills v. State of Madhya Pradesh*,[83] the Central Act was held to be a valid exercise of the residuary power. The Supreme Court observed that

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76. *Supra.* See also *State of UP v. Van Organic Chemicals Ltd.,* (2004) 1 SCC 225 at page 241 : AIR 2003 SC 4650.

77. *Hari Krishna v. Union of India,* AIR 1966 SC 619 : (1966) 2 SCR 22.

78. *Supra,* Sec. D.

79. *Second Gift Tax Officer v. D.H. Nazareth,* AIR 1970 SC 999 : (1971) 1 SCR 195.

80. *Azam Jah v. I.T. Officer, Hyderabad,* AIR 1972 SC 2319 : (1971) 3 SCC 621.

81. *Diamond Sugar Mills Ltd. v. State of Uttar Pradesh,* AIR 1961 SC 652 : (1961) 3 SCR 242.

82. *Supra,* Sec. D.

83. AIR 1966 SC 416 : (1966) 1 SCR 523.

what Parliament had done in the instant case was not merely to validate the invalid State statutes, but "to make a law concerning the cess covered by the said statutes and to provide that the said law shall come into operation retrospectively". Since the sugarcane cess does not fall within the competence of the States, it must inevitably lie within the Central sphere under the residuary entry. The ratio of this decision was later reiterated by the Court in the decision noted below.[84]

The most significant judicial pronouncement on the scope of residuary power of Parliament is *Union of India v. H.S. Dhillon*.[85] In this case, a Bench of seven Judges decided questions of far reaching significance as to the taxing powers of Parliament and the State Legislatures.

The question involved in *Dhillon* was whether the Centre could levy wealth-tax on the assets of a person including agricultural land. Wealth-tax does not fall within the ambit of Entry 49, List II,[86] and so the States could not levy it. Entry 86, List I, has the words "exclusive of agricultural land", and, therefore, that component of the Central law which refers to agricultural land could not come within that entry.[87] The main question, therefore, was whether the tax could be levied under the Centre's residuary power.

The antagonists of the tax argued that the words 'exclusive of agricultural land' in Entry 86, were words of prohibition which meant that Parliament was prohibited from including capital value of agricultural land in any law levying tax on capital value of assets. It was argued that when Parliament was specifically excluded under an entry to make a law on a subject, it could not do so under its residuary power. Another argument was that a matter would fall within Parliament's residuary power only if it is not mentioned in any of the three Lists, and since the subject of wealth-tax has been included in Entry 86, List I, it could not then fall within the residuary, and Parliament must legislate within the scope of entry 86 and could not go beyond the scope of that entry.

This argument found support from the Court's ruling in *Nazareth*[88] where the Court had taken the view that Parliament could invoke its residuary power only when the subject-matter of the impugned legislation fell under no entry in the three Lists. This meant that what was contained in entry 86, List I, must be excluded from the residuary power. This would mean that since the subject of Wealth Tax was included in entry 86, List I, the residuary power could not be invoked to support the Wealth Tax Act which must be supported only by reference to entry 86, List I. And as this entry excluded agricultural land from the scope of the Wealth Tax, in *Dhillon*, the *Nazareth* ruling was challenged.

The three Judges (Minority) on the Bench took the view that the residuary power contained in Art. 248 and Entry 97, List I, means power in respect of matters not enumerated in any of the three Lists. "Such a residuary power cannot,

84. *Shetkari Sahakari Sakhar Karkhana v. Collector, Sangli*, AIR 1979 SC 1972 : (1980) 1 SCC 381.
Also see : *In the matters of : District Mining Officer v. Tata Iron & Steel Co.*, JT 2001(6) SC 183 : (2001) 7 SCC 358.

85. AIR 1972 SC 1061 : (1971) 2 SCC 779.

86. *Supra*, Sec. D.

87. *Supra*, Sec. C.

88. *Supra*, footnote 79.

therefore, be ordinarily claimed in respect of a matter already dealt with under an Article or an entry in any of the three Lists." Once a topic or field of legislation has been enumerated and dealt with in any one of the entries in one of the Lists, there is no question of the residuary provision being resorted to. As the subject of wealth-tax falls within entry 86, List I, it is, therefore, taken out of the residuary field. Parliament cannot levy tax on the capital value of agricultural property either under Entry 86 or under its residuary power. In this view, the Judges drew support from the observations made by the Court in the *Nazareth* case cited above.

The other four Judges (majority) took a more expansive view of the residuary power of the Centre. These Judges dissented from the *Nazareth* ruling and took the view that Art. 248 was framed in the "*widest possible terms*" and so the scope of residuary power was vast. A matter not included in List II or in List III falls within the residuary field. No question need be asked whether the matter falls under List I or not. If the subject-matter does not fall in List II or List III, Parliament has power to legislate on it.

As SIKRI, C.J. observed : "... any matter, including tax, which has not been allotted exclusively to the State Legislatures under List II or concurrently with Parliament under List III, falls within List I, including entry 97 of that List read with Art. 248".

The impugned wealth-tax, therefore, has been justified under entry 97, List I, either exclusively, or read with entry 86, List I. The Court has also ruled that Parliament could supplement its power under an entry in List I with the residuary power to enact a law.[89] By a majority, the Supreme Court upheld the validity of the Wealth Tax Act.

This broad interpretation of the Centre's residuary power has given a new dimension to the powers of the Centre. Whatever is contained in List II and List III is excluded from the residuary power of the Centre. List I and the residuary are supplementary to each other. What is included in List I is not excluded from the residuary power of Parliament. Rather, the Centre can make a law seeking support from both.

Such an interpretation is justifiable so as to avoid any vacuum in the area of legislative powers as would have happened had the restrictive view of the residuary power been adopted by the Court. Undoubtedly, under the Constitution, the totality of the powers distributed between the Centre and the States cover the whole area of self-government within the territory of India. As the Court has observed in *Dhillon*:

> "It seems to us unthinkable that the constitution-makers, while creating a sovereign democratic republic, withheld certain matters or taxes beyond the legislative competency of the legislatures in this country either legislating singly or jointly."

Service tax levied on services rendered by *mandap*-keepers was held not to be a tax on land under Entry 49 of List II nor a tax on sale and purchase of goods

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89. For comments on *Dhillon's* case see, Alice Jacob, Residuary Power & Wealth Tax on Agricultural Property, 14 *J.I.L.I.*, 80 (1972); I.L.I. *Annual Survey of Indian Law* (1972), 431. SEERVAI, CONST. LAW OF INDIA, 1265-66 (1976); ANIRUDHA PRASAD, CENTRE & STATE POWERS UNDER INDIAN FEDERALISM 145-53 (1981).

under Entry 54 of List II read with Article 366(29-A)(*f*) but a tax imposed by Parliament under its residuary powers.[90] The use of electromagnetic waves in giving mobile phone connections was held not to be a sale for the purposes of Entry 54 of List II but part of a service in respect of which only Parliament could levy tax under Entry 97.[91]

The Rubber Act, 1947 (as amended in 1960) imposed new excise duty either on the manufacturers or on the owners of the estates. The constitutional validity of the duty was challenged on the ground that it was imposed on the use of rubber. It was argued that under entry 84, List I, excise duty could be levied only on the actual producers and manufacturers of rubber and not on the consumers or users of that commodity. Holding the levy to be valid, the Court ruled that what was called 'excise duty' on the use of rubber could not fall within entry 84, List I, but it was "a kind of non-descript tax which has been given the nomenclature of the duty of excise" which Parliament has undoubted competence to levy under its residuary power.[92] The Court asserted that under its residuary power, Parliament would have legislative competence even with regard to the imposition of a tax which does not fall within entry 84.

Underlying the significance of the Parliament's residuary power in the context of Indian Federalism, the Supreme Court has observed in *Satpal* :[93]

> "Complex modern governmental administration in a federal set-up providing distribution of legislative powers coupled with power of judicial review may raise such situations that a subject of legislation may not squarely fall in any specific Entry in List I or List III. Simultaneously, on correct appraisal it may not be covered by any entry in List II, though on a superficial view it may be covered by an Entry in List II. In such a situation, Parliament would have power to legislate on the subject in the exercise of residuary power under Entry 97, List I, and it would not be proper to unduly circumscribe, corrode or whittle down this power by saying that the subject of legislation was present to the mind of framers of the constitution because apparently it falls in one of the entries in List II, and thereby deny power to legislate under Entry 97."

To protect the State taxing powers from being unduly curtailed, the Supreme Court has cautioned in *International Tourist Corpn. v. State of Haryana,*[94] that before exclusive competence is claimed for Parliament to levy a tax under its residuary power, the legislative incompetence of the State Legislature must be clearly established. Parliament's residuary power is not to be interpreted so expansively as to whittle down the power of the State Legislatures. If there is a competing entry in List II *vis-a-vis* entry 97 in List I, the entry in the State List must be given a broad and plentiful interpretation. In this case, the Court rejected the argument that a tax on passengers and goods carried on national highways would fall under Parliament's residuary power. The Court ruled that such a tax falls under entry 56, List. II.[95]

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90. *T.N. Kalyana Mandapam Assn. v. Union of India,* (2004) 5 SCC 632 : AIR 2004 SC 3757; See also *Gujarat Ambuja Cements Ltd. v. Union of India,* (2005) 4 SCC 214 : AIR 2005 SC 3020. See also supra under Service Tax

91. *Bharat Sanchar Nigam Ltd. v. Union of India,* (2006) 3 SCC 1, at page 30 : AIR 2006 SC 1383.

92. *Jullundur Rubber Goods Manufacturers' Association v. Union of India,* AIR 1970 SC 1589 : (1969) 2 SCC 644.

93. *Satpal & Co. v. Lt. Governor of Delhi*, AIR 1979 SC 1950.

94. AIR 1981 SC 774 : (1981) 2 SCC 318.

95. *Supra*, Sec. D.

Similarly, in *The State of West Bengal v. Kesoram Industries Ltd.,*[1] education cess assessed and computed on the basis of value of coal produced from coal-bearing land and rural employment cess on the basis of dispatches from tea estates by the State of West Bengal were held to be legislatively competent under Entry 49 of List II which provides for taxes on land and buildings and not within the residuary power of legislation in the field of taxation under Entry 97 List I.

Parliament enacted the Expenditure Tax Act, 1987, to levy an expenditure tax at 10% *ad valorem* on "chargeable expenditure" incurred in hotels where the room tariff for a unit of residential accommodation was Rs. 400/- per day per person. The tax was payable by the person incurring the chargeable expenditure in such hotels. The constitutional validity of the tax was challenged on the ground that it was either a tax on 'luxuries' falling under entry 62, List II, or on 'sale or purchase of goods' falling under entry 54, List II and, thus, fell outside the Parliament's legislative sphere. On the other hand, the Centre supported the tax under its residuary power.

The Supreme Court upheld the tax in *Federation of Hotel & Restaurant v. Union of India.*[2] The Supreme Court ruled that the tax in question fell under the residuary power of Parliament as it was a tax on 'expenditure' and not on 'luxuries'. During the course of its judgment, the Court said regarding the Centre-State distribution of powers that "the constitutionality of the law becomes essentially a question of power which in a federal Constitution .... turns upon the construction of the entries in the legislative lists".[3] The responsibility to interpret the entries lies with the Supreme Court in the scheme of the Indian federal system. Further, the Court has also reiterated the proposition that 'these subjects which in one aspect and for one purpose fall within the power of a particular legislature may in another aspect and for another purpose fall within another legislative power".

At times, the Centre has used its residuary power to enable the States to levy and collect such taxes as are found to be beyond their legislative competence. One such example has already been mentioned above, e.g. Parliament has used its residuary power to validate State levy of sugarcane cess.[4] A cess on the water consumed by any local authority and every person carrying on any specified industry levied by Parliament through the Water (Prevention and Control of Pollution) Cess Act, 1977, has been held to be valid as a residuary tax.[5]

Reference may be made in this connection to *P. Kannadasan v. State of Tamil Nadu*[6] Some State Legislatures enacted provisions laying cesses/taxes on minerals under entry 50, List II. This tax was held invalid by the Supreme Court in *India Cement Ltd. v. State of Tamil Nadu*[7] on the ground that the States were incompetent to levy the tax in view of the passage by Parliament of the Mines and Minerals (Regulation and Development) Act made in terms of entry 54, List I.[8]

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1. (2004) 10 SCC 201 : AIR 2005 SC 1646 (see *supra* under Entry 49 List II).
2. AIR 1990 SC 1637 : (1989) 3 SCC 634.
3. AIR 1990 SC at 1647.
4. *Supra*, see, *Jaora Sugar Mills*, footnote 83.
5. *Municipal Corp., Jullundur City v. Union of India*, AIR 1981 P&H 287.
6. AIR 1996 SC 2560 : (1996) 5 SCC 670.
7. (1990) 1 SCC 12 : AIR 1990 SC 85.
8. This view has been substantially upset in *State of West Bengal v. Kesoram Industries (supra)*. For details, see, *supra*, Sec. D.

The financial position of the States would have become precarious if they had to refund the money collected over the years. Therefore, Parliament which had the power to levy the tax in question came to the rescue of the States. Parliament passed a validation Act saying that the invalidated provisions in the State laws would be deemed to have been enacted by Parliament and would remain in force till the date the Central Act was enacted. The Supreme Court upheld the validity of the Central Act in *Kamadasan*, mentioned above. The effect of the Act was that the relevant provisions of the State laws were "individually and specifically enacted by Parliament'.

COMMENTS

The scheme of allocation of taxing powers in India has been drawn with the following considerations in view:

(*a*) the Centre should have adequate resources at its command so as to be able to meet its high functions of defence, etc.

(*b*) The convenience of tax collection: which agency—Centre or State—may levy and collect what tax from the point of view of administrative convenience, efficiency and effectiveness. Therefore, taxes having a localized base have been entrusted to the States and taxes having a national base have been entrusted to the Centre.

(*c*) Taxes where it is desirable to maintain uniformity of incidence throughout the country have been allotted to the Centre, *e.g.*, stamp duties on negotiable instruments, taxes on transactions in stock exchanges.

(*d*) Taxes of which the tax-base, or incidence is not localised but extends beyond the confines of one State, or where aggregation may be necessary for purposes of levy of tax on a progressive basis, have been given to the Centre, for example income-tax can be collected easily on an all-India basis because a person may carry on business in several States and derive income therefrom. Similarly, customs duties may be collected most effectively by the Centre at the ports; the estate duty may be levied effectively by the Centre as a person may die leaving behind property in several States.

(*e*) Keeping economic development of the country in view, those taxes which have a close relationship with national economy, and which, if allotted to the States may create clogs on economic development, or may interfere with the movement of inter-State trade or commerce or development of a common market in India, have been allotted to the Centre, *e.g.*, excise duties or tax on inter-State sales. Thus, only taxes of a local nature have gone to the States.

A merit of the Indian scheme is that it seeks to avoid the complexities of overlapping and multiple taxation such as have arisen in other federations. Most of these problems arise because the Centre and the States have a large concurrent taxing area and simultaneously levy many taxes of the same kind on the same tax-base.

The key-note of the Indian Constitution is to secure an almost complete separation between Centre-State taxing powers so that a tax leviable by the Centre is not leviable by the States. The two cannot simultaneously levy a similar tax on the same tax-base. This has avoided the conflicts between the Centre and the States resulting in overlapping taxation. Also, taxes having as their tax-base, transactions or interests which are not localised in one State but may have nexus with more than one State, like income-tax on non-agricultural income, or corporation tax, or succession duty on non-agricultural property, have been given to the Centre and this has avoided multiple taxation of the same base by several governments.

One specific example may be cited to clarify the position. Railways are a Central undertaking and the responsibility to fix passenger fares rests on the Central Government. Tax on railway fares directly affects the railway fares and, therefore, it is desirable to have some co-ordination between the fares charged and the tax levied on them.

This consideration alone suggests that such a tax should be with the Central Government. But other factors also make this necessary. Suppose it is given to the States, then the rates of taxation might vary from State to State. There would also arise problems of allocation and collection. If a person travels over a long distance involving a journey through several States, then each State would seek to levy a tax on the portion of journey through it which would make calculations difficult. Then, which State would collect the tax—the one in which a journey originates or the one in which it ends; if one State collects, then it will have to apportion the same among other States through which the journey passes. To avoid these complications the levy of the tax is given to the Centre.

Such an allocation of taxing powers between the Centre and the States has largely succeeded in avoiding in India the inter-State and Centre-State competition for taxation and conflicts of jurisdiction which other federal countries are faced with. It was a wise step on the part of the Constitution-makers, for the underdeveloped economy of the country could ill-afford the luxury of inter-governmental conflicts for taxation as the taxing capacity of the people is extremely limited, and they form the least potential tax paying community in the world.

With the resources of the country being low and limited, and its needs relatively high, it was necessary to avoid inter-governmental competition in the tax field which, apart from causing inconvenience to tax-payers, would have seriously diminished the productivity of the taxes, which the country could ill afford. Multiple taxation places unduly high burdens on private enterprise and creates a lack of uniformity and efficiency in the tax burdens from State to State. Inter-State competition for revenue leads to litigation and administrative difficulties, raising costs of tax compliance and tax collection. The possibility of inter-State migration of wealth and industry comes into existence. The framers of the Indian Constitution have avoided most of these problems by judiciously distributing the taxing powers between the Centre and the States.

A criticism against the rigid scheme of Centre-State separation of taxing powers can be that in an emergency like war, the Centre might feel handicapped in raising the revenue it might require for its needs are bound to be higher in war-time than in peace-time, and the enumeration of Central taxing powers would hardly leave to it any manoeuverability in emergencies. The Indian Constitution, however, makes adequate provisions for meeting such a contingency. A two-thirds majority resolution by the Council of States enables the Centre to legislate for a year on any State subject-matter.[9] In serious situations, declaration of an emergency by the Centre enables it to levy any tax for the duration of the emergency.[10] In this way, if need be, the Centre can even levy those taxes which in normal times fall to the State sphere.

Although the scheme drawn by the framers of the Constitution for the division of the Centre-State taxing powers has several merits, *viz.*, it makes for economic tax collection, avoids harassment to the tax-payers by avoiding multiple and overlapping taxation and conflicts of Centre-State jurisdiction, and keeps the interests of national economy in view, still the framers could not take these principles to their logical end in drawing the scheme and had to make a few compromises which militate, to some extent, against these principles and give rise to several anomalies. A few examples may be given here.

(a) The power to levy estate duty and succession duty has been divided between the Centre and the States according as the property is non-agricultural or agricultural.[11]

This constitutional division of taxing authority between the Centre and the States cannot result in having a comprehensive system of death taxation. However, the inconvenience and irrationality of this aspect of the matter has been sought to be corrected by other arrangements.[12]

(b) Similarly, income-tax has been divided between the Centre and the States according to the taxable income being non-agricultural or agricultural.[13]

It is an anomaly that a subject of taxation, which on the basis of the principle of progression and aggregation should have been one integral whole, has been so divided. It would be inequitable to tax merely the non-agricultural income leaving agricultural income untaxed or taxed lightly by the States. The inequity could be illustrated by means of an example. Suppose X's net income in a year is Rs. 10,000 all non-agricultural, while Y's net income is the same but wholly agricultural, and Z's income of Rs. 10,000 may be partly agricultural (Rs. 5,000) and partly non-agricultural (Rs. 5,000). X is subject to a Central income-tax. Z's Rs. 5000 would be subject to a Central tax but the progression of rate applicable to him is bound to be lower than that applicable to X, and Z's agricultural income of Rs. 5,000 may either go wholly untaxed, or be taxed by the State at a much lower figure than his non-agricultural income. In any case, even if both the Centre and the State levy the income-tax, the total liability of Z may still be less than that of X, for while X's income is being taxed as one unit, Z's income will be bifurcated into two parts, and the rate applicable to each of the parts would be less than the rate applicable to the whole income taken as one unit. Y may go completely untaxed if the State is not levying the income-tax. Even if he is taxed, the rate applicable may not be as steep as is applied by the Centre to non-agricultural income.

The best thing would have been to give to the Centre the entire power of levying death duties and income taxation, but that would have appreciably re-

9. Art. 249, Ch. X, Sec. J, *supra*.
10. Art. 250, Ch. X, Sec. J, and Art. 352, *infra*, Ch. XIII, Sec. B.
11. *Supra*, see entries 87 and 88, List I and entries 47 and 48, List II; Secs. C and D, *supra*.
12. *Supra*, Ch. X, Sec. J.; Also see, *supra*, Sec. G.
13. *Supra*. Entry 82, List I and entry 46, List II, *supra*, Secs. C and D.

duced the powers of the States. But since both the Central taxes are shared taxes, as is explained below,[14] there should not have been much of an objection to centralization of this field. While the area of death duties has been co-ordinated and the problems of divided jurisdiction solved,[15] similar problems in the area of income-tax remain.

The levying of an agricultural income-tax is a politically loaded question for the States, as the majority of voters live in the country-side and that is why the States are reluctant to cultivate this field. However, in view of the present-day political complexion of the country, any adjustments in taxing powers, which will reduce States' power, is not feasible. Some of the anomalies can be solved by more and more States levying agricultural income-tax at rates parallel to those levied by the Centre. It may also be better to have some provision of aggregation of income with a possibility of credit by one government for the tax paid to the other government. To achieve this, Centre-State co-ordinated effort is needed.

(c) Another anomaly is the allocation of 'excise' to the Centre and 'sales tax' to the States. Both are taxes on consumption and tend to push up prices of consumer goods on which they are levied.

It is felt that some steps should be taken to co-ordinate the two taxes. Some limited steps have been taken in this respect in case of a few commodities, but the major problem still remains.[16]

The problem is becoming serious as both these taxes are being levied progressively at higher levels. The Fourth Finance Commission was asked to suggest if a ceiling could be prescribed on State sales taxes. But the Commission failed to evolve any formula and suggested mutual agreement between the Centre and the States.[17]

(d) The States' powers to levy sales tax or tax on carriage of goods, *etc*., also create problems in the way of flow of trade and commerce.[18] The fact is that the Indian economy tends to be national and, thus, local taxation thereof creates problems. Businessmen resent sales tax because of the problems of inter-State sales taxation.

(e) Similarly, taxation of motor vehicles by the States hampers the evolution of an All-India transportation system.

If prohibition policy is seriously implemented, States would lose excise revenue which is sizeable at present. States have successfully used their power to tax land to raise revenue by taxing mineral bearing lands.[19] The Supreme Court has, on the whole, so far sought to give a liberal interpretation to the taxing powers of the States.

H. FEES

There is no *generic* difference between a 'tax' and a 'fee', but the Indian Constitution distinguishes between the two concepts for legislative purposes.

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14. *Infra*, Sec. K(i).
15. See under entry 88, List I, *supra*, Sec. C.
16. *Infra*, Sec. K.
17. *Report*, 38-45 (1965).
18. *Infra*, Ch. XV.
19. See *Supra* Sec. D.

Each List has a number of tax entries, but at the end also has an entry authorising levy of fees in respect of any of the matters included in the List. For example, entry 96, List I, reads : "Fees taken in respect of any of the matters within this List but not including fees taken in any court."[20] Similarly, entry 66, List II, runs: "Fees in respect of any of the matters in this List, but not including fees taken in any court".[21] Entry 47, List III, is also couched in similar terms as the other two entries mentioned above.[22]

The expression "any of the matters in this list" necessarily includes also the entries relating to taxation. This means that a fee may be levied even under an enactment relating to the imposition of a tax. For example, under entry 54, List II, a tax can be levied on the sale or purchase of goods. But licences are issued to dealers for permitting them to carry on business of buying and selling goods, and a licence-fee may be charged for the purpose.

It would appear from the above that the scope for levying fees is much broader than that for levy of taxes. Whereas a tax is to be confined to the few specific tax entries in each List,[23] a fee can be levied in respect of all the entries—tax or non-tax—in the three Lists by the concerned Legislature. The first important incident of the difference between 'tax' and 'fee' is that whereas no tax can be levied outside the tax entries, fees can be levied in respect of a non-tax entry as well. As for example, a State levy on public trusts is invalid as a 'tax' as there is no such tax entry, but it is valid as a 'fee' under entry 47 of List III. A fee may be levied even under a law relating to the imposition of a tax, *e.g.*, licence fee charged from dealers under the Sales Tax Acts.

Another significant difference between "fee" and "tax" is that Arts. 110(2) and 199(2) which deal with 'Money Bills' lay down expressly that a Bill will not be deemed to be a 'Money Bill' by reason only that it provides for the imposition of fines, or the demand or 'payment of fees' for licences, or 'fees for services rendered,' whereas a Bill dealing with imposition or regulation of a tax will always be regarded as a Money Bill.[24] These provisions should, however, be read as excluding from the category of Money Bills not every 'licence fee' but only such as does not amount to a 'tax'. In some situations, a tax can be collected in the form of a licence fee and this could not be exempted from the definition of a Money Bill. The use of the term 'licence fee' in a statute is not decisive of the nature of the levy in question.

This, therefore, raises the question as to how to distinguish between a 'tax' and 'fee'. Over a period of time, as the following discussion will show, there has occurred a sea change in the approach of the Supreme Court towards identifying a levy as 'fee'.

To begin with, the Court adopted a restrictive view of 'fee' and promoted the theory of *quid pro quo* between the 'fee' charged and the 'service' rendered in lieu thereof. This was followed by a period when the Court by and large shed this restrictive approach and more or less gave up the *quid pro quo* theory adopting the approach of regulatory nature of a 'fee'. This gave a far greater leeway to the

20. *Supra*, Sec. C.
21. *Supra*, Sec. D.
22. *Supra*, Sec. E.
23. *Supra*, Sec. F.
24. See, Ch. II, Sec. J(ii)(c) and Ch. VI, Sec. F(ii), *supra.*

legislatures in the matter of levying fees for various purposes. Of late, the Courts have reverted more to the earlier view without insisting on an exact proof of *quid pro quo*.

(a) Theory of *quid pro quo*

To begin with, the Supreme Court propounded the view that a tax is a compulsory exaction of money by a public authority for public purposes, to meet the general expenses of the State without reference to any special benefit to be conferred upon the tax-payers. The taxes collected are merged in the general revenue and applied for general public purposes. Fees, on the other hand, are payments for some special service rendered, or some work done, for the benefit of those from whom payments are demanded. Thus, in fees, there is always an element of *quid pro quo* which is absent in a tax. The Court treats *quid pro quo i.e.*, some service rendered to the payer of the fee, as an essential element of the concept of fee.

A payment would be a fee if it fulfils the following two elements :

(1) it must be levied in consideration of certain services rendered to the individuals by some governmental agency; and

(2) payments demanded for rendering such services should be kept apart, or specifically appropriated for that purpose, and not merged in the general revenue to be spent for general purposes.

If the funds are kept separate from the general funds, then they can be used for the service for which they have been collected. If any balance is left in a year, then it can be spent later on the same service. But if the fee receipts are mixed up with the general funds, then the surplus may get lost and the fee collected for specific service may not be fully utilised for that service. In *Swamiar*[25], the Supreme Court observed in this connection:

> "... in a fee it is some special benefit accruing to the individual which is the reason for payment in the case of fees; in the case of a tax, the particular advantage if it exists at all is an incidental result of state action. As fee is a sort of return or consideration for services rendered, it is absolutely necessary that the levy of fees should, on the face of the legislative provision, be correlated to the expenses incurred by Government in rendering the services..."

In the instant case, a levy on religious institutions was held to be a 'tax' and not 'fee' because the money raised was not earmarked for defraying the expenses in performing the services. The collections went to the State Consolidated Fund out of which were met the expenses of the Commissioner. There was no correlation between the expenses incurred by the Government and the contributions raised, and, thus, the theory of return or *quid pro quo* did not apply. In the instant case, the percentage of contribution leviable was graded according to the income derived by the institution. The levy being a tax was held unconstitutional as it did not fall under any tax-entry in List II.

It is to be seen that the most restrictive view of 'fee' was propounded by the Supreme Court in the *Swamiar* case. Thereafter, the Court gradually relaxed its approach as is evident from the following discussion.

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25. *Commr., H.R.E. v. L.T. Swamiar,* AIR 1954 SC 282 : 1954 SCR 1005.

An Orissa Act laid down that every temple having income exceeding Rs. 250 should make an annual contribution, on a percentage basis of the income, for meeting the expenses of the Commissioner of Hindu Religious Endowments and his staff—the machinery set up for the due administration of the affairs of religious institutions. The collections were to form a separate fund and were in consideration of the service rendered by the Commissioner, *viz.*, to ensure proper application of the endowment funds. The levy was held to be 'fee'.[26]

A levy on lessees of coal mines to meet the expenditure for providing amenities like communication, water supply and electricity for the better development of the mining area, and to meet the welfare of the labour employed, has been held to be a 'fee'.[27] The money raised was kept in a separate fund out of which the amenities were to be provided. The Court asserted that in case of fee, there must always be correlation between the fee collected and the service to be rendered.

To make a levy a fee, the services rendered for it must benefit, confer advantage on, the person who pays the levy. A mere control exercised on the activities of the person paying the levy, so as to make these activities more onerous, is not such a service rendered to him as to make the levy a 'fee'.[28] A mere inspection of cinema houses twice a year with a view to ensure that the terms of the license were observed does not amount to rendering service to the owners of cinemas and so the levy for the purpose cannot be regarded as a 'fee' as there was no correlation between the amount of levy with the costs of any service. The Supreme Court ruled that fees for licence and fees for services rendered were envisaged to be different kinds of levy. Thus, the Court distinguished between fees for services rendered and those for regulatory purposes.[29]

In *Indian Mica & Micanite Industries v. State of Bihar*,[30] the Supreme Court laid emphasis on three elements: (*i*) to be a fee, the State should render some service to those from whom the fee is charged; (*ii*) a mere regulation of trade in public interest is no service to the person required to pay the levy; (*iii*) the fee charged is to have a reasonable correlation with the expenses incurred in rendering the service, *i.e.*, the levy must be a *quid pro quo* for the service rendered.

But in such matters. it is not possible to have an exact correlationship. The correlation may, however, be of a 'general character' and not of 'arithmetical exactitude'. The correlationship between the services rendered and the levy of fee is essentially a question of fact. It is for the State to place materials before the court to show what service is being rendered to the person required to pay the levy, what is the probable cost being incurred thereon and how much amount is being realised by way of fees. Where the State supervision is meant only to see that tax is not evaded, the State renders no service to the concerned person but serves its own interest. In this case, the Court emphasized that generally speaking by granting a licence, the State does not confer any privilege or benefit on any one. All that it does is to regulate a trade, business and profession in public inter-

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26. *Jagannath v. State of Orissa,* AIR 1954 SC 400 : 1954 SCR 1046.
Also see, *Ratilal v. State of Bombay,* AIR 1954 SC 388 : 1954 SCR 1055; *S.T. Swamiar v. Commr., H.R.E.,* AIR 1963 SC 966 : 1963 Supp (2) SCR 302.

27. *Hingir-Rampur Coal Co. v. State of Orissa*, AIR 1961 SC 459 : (1961) 2 SCR 537.

28. *Cooverji B. Bharucha v. Excise Commr.*, AIR 1954 SC 220 : 1954 SCR 873.

29. *Corporation of Calcutta v. Liberty Cinema*, AIR 1965 SC 1107 : (1965) 2 SCR 477.
Also see, *infra*, footnote 49.

30. AIR 1971 SC 1182 : (1971) 2 SCC 236.

est. It will thus be seen that the Court did not envisage that a 'fee' could be levied merely for regulatory purposes.

Under a State law, a fee was payable by sugar mills to the Cane Development Council which was to perform certain services to the mills. The Supreme Court held that no fee was payable by the mills for the period when the council was not in existence as no service was rendered to the mills.[31]

Water charges levied by a municipality as a percentage of annual rateable value of building constitute a tax on lands and buildings, falling under entry 49 of List II,[32] but amount to 'fee' when levied according to the quantity of the water consumed.[33]

In *Nagar Mahapalika, Varanasi v. Durga Das*,[34] a licence fee on owners and drivers of rickshaws was held invalid, for the amount collected thereby was much larger than the expenses incurred by the Board to render services to the rickshaw owners and drivers. Here the concept of *quid pro quo* was applied very strictly. An interesting feature of the case is that the amount spent by the Mahapalika on discharging its statutory duties was not taken into consideration for, as the Court said, "Licence fee cannot be imposed for reimbursing the cost of ordinary municipal services which the Municipal Board was bound under the statute to provide to the general public."

The same principle was applied in *Govt. of Andhra Pradesh v. H.M.T.*[35] The Supreme Court ruled that the totality of statutory functions of a *gram panchayat* could not justify a fee. There should be services rendered individually to the person on whom the fee is imposed.

The fee payable by a factory owner under the Factories Act has been held to be a 'fee' as the inspection carried on by the inspectors confers benefit on the factory owners as well. A large number of provisions in the Act, particularly those dealing with safety, involve a good deal of technical knowledge. During the course of discharging their duties, the inspectors give proper advice and guidance which avoid many accidents. The bulk of the licence fees realised is actually spent on services rendered to the factory owners.[36]

In *State of Maharashtra v. Salvation Army*,[37] the Court again emphasized upon the correlation between the fee charged and the service rendered. The Court observed:[38]

> "As a fee is regarded as a sort of return or consideration for services rendered, it is necessary that the levy of fees should be correlated to the expenses incurred by the agency in rendering the services".

The Court insisted that two elements were essential for a levy to be regarded as a fee: (1) it is levied in consideration of certain services which the individuals accept either willingly or unwillingly; (2) it must not go to the general revenue of

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31. *Jaora Sugar Mills v. State of Madhya Pradesh*, AIR 1966 SC 416 : 1966 (1) SCR 523.
32. *Kendriya Nagrik Samiti, Kanpur v. Jal Sansthan*, AIR 1982 All. 406; *supra*, Sec. D.
33. *Nizam S. Factory v. Bodhan Municipality*, AIR 1965 AP. 91.
34. AIR 1968 SC 1119 : (1968) 3 SCR 374.
35. AIR 1975 SC 2037 : (1975) 2 SCC 274.
36. *Delhi Cloth & General Mills v. Chief Commn., Delhi*, AIR 1971 SC 344 : (1970) 2 SCC 172.
37. AIR 1975 SC 846 : (1975) 1 SCC 509.
38. *Ibid*, at 851.

the State but be earmarked to meet the expenses on the service rendered. The Court insisted that the "fee must, as far practically as possible, be commensurate with the service rendered". In this case, a 2% charge being levied on charities to meet the expenses of the charity commissioner was held to be *ultra vires* since 1970 as there was a surplus of 54 lakh rupees. The Court ruled that in fixing the fee regard must be had to the surplus.

The concept of *quid pro quo* was very strictly applied by the Supreme Court in *State of Andhra Pradesh v. Hindustan Machine Tools Ltd.*:[39] The Court observed:

> "One cannot take into account the sum total of the activities of a public body like a *gram panchayat* to seek justification for the fees imposed by it. The expenses incurred by a Gram Panchayat or a municipality in discharging its obligatory functions are usually met by the imposition of a variety of taxes. For justifying the imposition of fees the public authority has to show what services are rendered or intended to be rendered individually to the particular persons on whom the fee is imposed."

In the *Chief Commissioner, Delhi v. Delhi Cloth & General Mills Co. Ltd.*,[40] a registration fee charged on the percentage basis on the registration of debentures was held bad. The Court found that the registration fee realised had no correlation with the expenditure incurred on maintenance, registration, organisation, etc., and also that the fees realised formed part of the general revenues of the State.

In *Kewal Krishan v. State of Punjab*,[41] while the Supreme Court held that market fee could be levied on an *ad valorem* basis on the agricultural produce bought or sold by the licensees in the notified market area, it did emphasize that a substantial portion of the fee realized must be spent for rendering services to the licensees in the notified market area in relation to the transaction of purchase or sale of the agricultural produce. Utilisation of the fund for an ulterior purpose, howsoever benevolent or charitable, cannot be permitted, otherwise the whole concept of 'fee' would collapse. There is the principle of *quid pro quo* between the payer of the fee and the authority charging it, for the validity of the fee charged. But this principle cannot be satisfied by rendering some remote service. The special service rendered must be to the payer of the fee. Though it may not be an exact equivalent of the fee with a mathematical precision, yet it must be established broadly and reasonably by the fee charging authorities that the amount is being spent for rendering services to those on whom falls the burden of the fee.

In the instant case, the Court found some of the purposes mentioned in the Act for which the fee collected could be spent to be impermissible, such as, propaganda in favour of agricultural improvements and thrift; production and betterment of agricultural produce or imparting education in agriculture, etc. Also, taking a reasonable and practicable view on the basis of facts and figures placed before the Court, it ruled that a rate of 2% rather than 3% was sustainable on the basis of legal expenditure in relation to the market fee income.[42]

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39. AIR 1975 SC 2037, 2044 : (1975) 2 SCC 274.
40. AIR 1978 SC 1181 : (1978) 2 SCC 367.
41. AIR 1980 SC 1008 : (1980) 1 SCC 416.
42. In *Ram Chandra Kailash Kumar & Co. v. State of Uttar Pradesh*, AIR 1980 SC 1124 : 1980 Supp SCC 27, a market fee of 1% on the price of agricultural produce sold was held valid subject to rendering adequate service by market committees.
Also, *Sajjan Mills Ltd. v. Krishi Upaj Mandi Samiti, Ratlam*, AIR 1981 MP 30; *M.N. Aggarwal v. Krishi Upaj Mandi Samiti, Itarsi*, AIR 1983 MP 126.

In the case noted below,[43] the Supreme Court has again distinguished between a 'fee' and a 'tax'. The 'fee' is levied under entry 66, List II, by a State. The power to levy fee is co-extensive with its powers to legislate with respect to substantive matters and fee is levied with respect to the services which would be rendered by a State under such a law. A fee is payment levied by an authority in respect of services performed by it for the benefit of the payer. On the other hand, a tax is payable for the common benefits conferred by the Authority on all tax payers. "A fee is a payment made for some special payment made for some special benefit enjoyed by the payer and the payment is proportional to such benefit. Money raised by fee is appropriated for the performance of the service and does not merge in the general revenue."

The Court has observed further: "While there is no *quid pro quo* between a taxpayer and the authority in case of a tax, there is a necessary correlation between fee collected and the service intended to be rendered. Of course the *quid pro quo* need not be understood in mathematical equivalence but only in a fair correspondence between the two. A broad correlationship is all that is necessary."[44] In the instant case, the levy in question was held to be a tax as there was no *quid pro quo.*

In course of time, the Supreme Court started taking a more flexible and extended view of the concept of 'fee'. For example, it was said that it is not an essential element of a fee that it should be credited to a separate account and not to the Consolidated Fund. In this connection, attention has been drawn to Art. 266 and so it has been observed that if services rendered are not by a separate body like the Charity Commissioner, but by a government department, the character of the imposition would not change even if credited to the Consolidated Fund.[45]

In *Shri Admar Mutt v. Commr., H.R. & C.E.*,[46] the Court upheld a fee varying from 3 to 5% of the annual income of a religious institution payable to the Commissioner of Religious Endowments because the total collections were just equal to the department's total expenditure. The Supreme Court, however, observed that a levy would not become a tax merely because of the absence of uniformity in its incidence, or because of compulsion in its collection, or because some contributors do not obtain the same degree of services as others may. A mathematical equivalence between fees paid and service rendered is not required. This was a case where fees were chargeable according to the paying capacity and not according to the service rendered to each individual institution as there were many institutions which received the service but had very little paying capacity. The judicial opinion in this case does indicate some flexibility in the theory of *nexus* between the service rendered and the fee charged.

In *Southern Pharmaceuticals v. State of Kerala*,[47] a levy on the supply of rectified spirit to the manufacturers of toilet and medicinal preparations was justified

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43. *Sri Krishna Das v. Town Area Committee, Chirgaon,* AIR 1991 SC 2096 : (1990) 3 SCC 645.

44. *Ibid,* at 2104.

45. *State of Rajasthan v. Sajjanlal*, AIR 1975 SC 706; *Sreenivasa General Traders v. State of Andhra Pradesh,* AIR 1983 SC 1246 : (1983) 4 SCC 353.

46. AIR 1980 SC 1 : (1979) 4 SCC 642.

47. AIR 1981 SC 1863 : (1981) 4 SCC 391.

as a fee. 'Fee' can be payable 'as a condition of a right to carry on a business.' No one has a fundamental right to the supply of rectified spirit which is an intoxicating liquor. Its supply is regulated by the State from a distillery or a spirit ware-house.[48] A fee may be charged for the privilege or benefit conferred, or service rendered, or to meet the expenses connected therewith. "It is in consideration for the privilege, licence or service". A manufacturer of preparations using alcohol may have to bear the cost of establishment. The government may deploy supervisory staff in a bonded manufactory for its own protection to prevent the leakage of revenue, but the licensee also receives a service in return. The Court clarified that merely because the collections are taken to the Consolidated Fund of the State and are not the separately apropriated towards the expenditure for rendering the service is not by itself decisive of the nature of the levy.

The Court also observed in the instant case that the element of *quid pro quo stricto sensu* was not always a *sine qua non* of a fee. This statement does indicate a new approach, a break from the past, somewhat liberalization of the judicial approach towards the concept of fee.

A good example of the liberal judicial view of the concept of fee is furnished by the Supreme Court pronouncement in *Delhi Municipality v. Mohd. Yasin*[49] where the concept of 'service rendered' for a 'fee' was very much diluted. The municipality enhanced 8 times the fee chargeable for slaughtering animals at its slaughter houses. The expenditure shown in the municipal budget under the item slaughter houses was much less than the anticipated collection from the enhanced fees. The municipality, however, argued that the budget only showed the items incurred directly and exclusively on slaughter houses but, in addition, there were several other items in the budget which included expenditure incurred in connection with them. The Delhi High Court held the enhancement in fees as invalid but the Supreme Court, on appeal, held the same to be valid.

According to the Supreme Court, fee is a payment for services rendered, benefit provided or privilege conferred. The relation between the fee and services rendered or advantages conferred need not be direct, "a mere causal relation may be enough". Neither the incidence of the fee nor the service rendered need be uniform. That others, besides those who pay the fees are benefited, does not detract from the character of the fee. "The special benefit or advantage to the payers of the fees may even be 'secondary' as compared with the primary motive of regulation in the public interest." "*Quid pro quo* in the strict sense is not the one and only true index of a fee; nor is it necessarily absent in a tax." Expenditure need not be incurred "directly or even primarily in connection with the special benefit or advantage conferred". If others than those who pay the fee are benefited, it does not detract from the character of the fee. Further, the Court is not to assume the role of a cost-accountant. The Court is not to weigh "too meticulously" the cost of services rendered as against the amount of fee collected so as to evenly balance the two. "A broad correlationship is all that is necessary." "There need not be any fastidious balancing of the cost of the services rendered with the fees collected". That the money collected from the fees goes not in a separate fund but in the Consolidated Fund does not also necessarily make a fee a tax.

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48. On this point, see, *infra*, Ch. XXIV, Sec. H.
49. AIR 1983 SC 617 : (1983) 3 SCC 229.

In *Sreenivasa General Traders v. State of Andhra Pradesh*,[50] the Supreme Court further liberalized the concept of fee and made it even more flexible. The rate of market fee levied by market committees was increased by the State Government from 1/2% to 1% of the aggregate amount for which notified products were purchased or sold at notified market areas. This increase was challenged on the ground that there was no *quid pro quo, i.e.*, there was no correlation between the increase in the rate of market fee and the service rendered.

Rejecting the contention and upholding the increase in fee, the Court emphasized that it was not always possible to work out with mathematical precision the amount of fee required for the services rendered and to collect only so much as would be just sufficient to meet the expenses in one year. It would be wrong to take only one year or a few years into account to decide whether fee was commensurate with the service rendered. An overall picture must be taken while dealing with the question whether there was correlation between the increase in fee and services rendered. In the instant case, the Court was satisfied that the income would not be sufficient even after the increase to meet the expenditure of the market committees.

So far, the Court said nothing new and only reiterated what it had said in earlier cases. But then the Court went on to emphasize that the word 'fee' need not be given a rigid technical meaning. While the power to levy fee "is conditioned by the fact that it must be 'by and large' a *quid pro quo* for the services rendered", such a correlationship is of 'general character and not of mathematical exactitude'. All that is necessary is that there should be a 'reasonable relationship' between the levy of the fee and the services rendered. Fee need not have direct relation to the actual service rendered by the authority to each individual who obtains the benefit of the service. The element of "*quid pro quo* in the strict sense is not always a *sine qua non* for a fee."

In the instant case, all the purposes mentioned in the relevant law for which collections from fee were to be spent were extremely beneficial to the growers and the traders. The phrase 'payer of the fee' represents "collectively the class of persons to whom the benefit is directly intended by the establishment of a regulated market" and not the actual individual who belongs to that class, *i.e.* the trader. Thus service does not mean service to each individual payer of fee but to the users of the market, *i.e.*, growers and traders of notified agricultural produce. The Court expressly dissented from some of the observations made by it earlier in the *Kewal Krishan* case.[51]

It will thus be seen that in *Srinivasa*, the Supreme Court diluted the concept of fee at least in two respects : (1) while accepting the proposition that fee is collected for the services rendered, the Court held that the whole of the benefit need not be conferred on the payers of the fee; and (2) element of *quid pro quo* need not be established with arithmetical exactitude; it is enough if a good and substantial portion of the amount collected by way of fees is spent on rendering

50. AIR 1983 SC 1246 : (1983) 4 SCC 353.
51. *Supra*, footnote 41.

services. In fact, the Court went to the extent of saying that the element of *quid pro quo* in the strict sense is not always *sine qua non* for a fee.[52]

In *Om Prakash Agarwal v. Giri Raj Kishore,*[53] a cess was imposed on *ad valorem* basis at the rate 1% of the sale proceeds of the agricultural produce brought or sold in a market area. The money thus collected was to be spent on rural development. The levy was held invalid. In spending money collected through the cess, the interest of the dealers was not at all kept in view. There existed no correlation between the amount paid by way of cess and the services rendered to a person from who it was collected.

The case of *City Corporation of Calicut v. Thachambalath Sadasivan*[54] reflects the change which occurred in judicial thinking as to the nature of fee. The Supreme Court ruled that the traditional concept of *quid pro quo* in a fee has been undergoing transformation. Though the fee must have relation to the services rendered, or the advantage conferred, it is not necessary to establish that *those* who pay the fee must receive direct or special benefit or advantage of the services rendered for which the fee is being paid. The Court held that if one who is liable to pay receives general benefit from the authority levying the fee, the element of service required for collecting fee is satisfied.

In *District Council of Jowai Autonomous District v. Divet Singh,*[55] the Supreme Court again fell back upon the concept of *quid pro quo* to support levy of a fee. The district council levied royalty on timber coming from private forests. The Supreme Court invalidated the levy. The Court ruled that the levy could not be regarded as royalty as the forests did not belong to the district council. It could also not be justified as tax on land. In pith and substance, it was a tax on forest produce grown on private lands. The levy could be justified as fee, but it could be imposed only as *quid pro quo* for services rendered by the district council to the forest owners and contractors, but there was no evidence to show the expenses incurred by the district council towards such services and the total amount of royalty collected by it.

In *Sirsilk*,[56] the Supreme Court ruled that when the entire proceeds of the fee are utilised in financing the various projects undertaken by the Textiles Committee, it cannot be said that there is no reasonable and sufficient correlation between the levy of fee and the services rendered by the Textiles Committee. The Court ruled further that when the levy of the fee is for the entire textile industry, there is sufficient *quid pro quo* between the levy recovered and the services rendered to the industry as a whole.

In *Krishi Upaj Mandi Samiti v. Orient Paper & Industries Ltd.,*[57] a levy on the sale of bamboo by the Forest Department to the mill, payable to the market committee was upheld as a 'fee'. The Court rejected the argument of the mill that the committee performed no service to the mill which paid the levy. The Court

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52. This view has been reiterated by the Supreme Court in *Om Prakash v. State of Punjab,* AIR 1985 SC 218 : (1985) 1 SCC 345; *City Corpn. v. T. Sadasivan,* AIR 1985 SC 756 : (1985) 2 SCC 112.

53. AIR 1986 SC 726 : (1986) 1 SCC 722.

54. AIR 1985 SC 756 : (1985) 2 SCC 112.

55. AIR 1986 SC 1930 : (1986) 4 SCC 38.

56. *Sirsilk Ltd. v. Textiles Committee,* AIR 1989 SC 317 : 1989 Supp (1) SCC 168.

57. (1995) 1 SCC 655 : (1994) 7 JT 414.

ruled that the market committee spent the money on the improvement of the infrastructure to further the object of the Act. The fact that the mill was not the direct beneficiary of the facilities provided by the committee does not absolve it from payment of the market fees. The facilities were meant for the benefit of all the buyers and sellers of all the agricultural produce within the market area.

The Court now stated the proposition: "It is enough if there is a broad, reasonable and general correlationship between the levy and the resultant benefit to the class of people on which the fee is levied, though no single payer of the fee receives direct or personal benefit from those services. It is immaterial that the general public may also be benefited from some of the services if the primary service intended is for the payers of the fees." [58] It will be seen that the emphasis has shifted from provision of services to the individual who pays the fee to the payers of the fee as a class.[59] It is enough that there is a "broad, reasonable and general correlationship" between the levy and the resultant benefit to the "class of people" who are required to pay the fee though no single fee payer receives direct or personal benefit from those services.[60]

(a) REGULATORY FEE

In course of time, the traditional concept of *quid pro quo* started undergoing a transformation as the concept of fee based on benefit to the payers of fee was found to be too restrictive a concept. Accordingly, the Supreme Court started emphasizing that the element of *quid pro quo stricto sensu* is not always a *sine qua non* of a fee. The reason for this change in judicial stance was that most of the present-day state activities are regulatory in nature, and, for this purpose, licensing is regarded as an effective administrative technique.

The idea underlying regulation is more of public interest rather than an individual benefit. In most of the cases, licence fees are levied to meet the expenses of regulation. In this context, the idea of 'benefit' to the licensee is too narrow a concept. It will be more in accord with the present-day realities to accept the minority view in the *Liberty Cinema* case[61] that imposition of charges for supervision, inspection and control of private activity may be regarded as 'fee'.

Articles 110(2) and 199(2) recognise the two concepts *viz.,* "fees for licences" and "fees for services rendered". This indicates that there are these two types of fees.[62]

There may however arise the question of correlation between the fee charged and the cost of regulation. In the *Liberty Cinema* case, the cinema owner was required to pay annually a sum of Rs. 6000 and it was no body's case that this sum was required only to effect inspection of the cinema twice a year. Here, licensing was being used clearly as a technique of raising revenue for the corporation and so the so-called 'licence fee'could justifiably be regarded as a tax. The

58. *Ibid*, at 674.
59. *Krishi Utpadan Mandi Samiti v. Ashok Kumar Dinesh Chandra*, (1996) 10 SCC 100 : 1996) 7 JT 545; *Etikoppaka Coop. Agricultural Industrial Society v. Secretary, Agricultural Market Committee*, AIR 1999 AP 114; *Belsund Sugar Co. v. State of Bihar*, AIR 1999 SC 3125 : (1999) 9 SCC 620.
60. (1995) 1 SCC 659.
61. See, *supra*, footnote 29.
62. See, Chs. II, Sec. J(ii)(c), and VI, Sec. F(ii), *supra.*

view propounded by the minority in *Liberty Cinema* has now come to be accepted by the Supreme Court.

Through a series of recent cases, distinction between 'compensatory fee' and 'regulatory fee' has now become established. The expression "licence fee" does not necessarily mean a fee in lieu of services and that no *quid pro quo* need be established in such a case.[63] Licence fee can be regulatory when the activities for which a licence is given require to be regulated or controlled.

The State of Tamil Nadu passed an Act to regulate chit funds in which middle class and the poor participate in large numbers. An organisation with the Registrar of Chit Funds was established to supervise and regulate chit funds. A fee graduated according to the value, and the number of subscribers of the chit fund, was levied for registration of bye-laws with the Registrar of Chit Funds. The Supreme Court upheld the validity of the licence fee. The Court observed that the object of the Act was to protect the interests of the subscribers of chit funds and more their number, more the burden on the authorities and, consequently, more fee is needed to meat the expenditure.[64]

In *Vam Organic Chemicals Ltd. v. State of Uttar Pradesh*,[65] the Supreme Court avowedly accepted the notion of fees charged for licences, *i.e.* regulatory fees. The Court now distinguished between "regulatory fees" and "compensatory fees" *i.e.* fees for services rendered. In case of regulatory fee, like the licence fee, where the activities for which licence is given require to be regulated or controlled, existence of *quid pro quo* is not necessary although the fee imposed must not be in the circumstances of the case, excessive, keeping in view the quantum and nature of the work involved in the required supervision. In the instant case, a licensing system for denaturation of spirit and a fee at the rate of 7 paise per litre was imposed. Keeping in view the quantum and nature of the work involved in supervising the process of denaturation and the consequent expenses incurred by the State, the fee imposed was held to be reasonable and proper.

The Hyderabad Municipal Corporation levied a licence fee on eating houses, lodging houses, restaurants etc. This levy was challenged on the ground of lack of *quid pro quo* between the fees charged by the municipality and the service rendered to the licensees. In the case noted below,[66] the Supreme Court upheld the levy as a fee on the ground that the municipality performed regulatory and supervisory functions.

The Court again emphasized that a licence fee may be either regulatory or compensatory. The licence is issued to a restaurant subject to several conditions being fulfilled by the licensee. The Corporation inspects the licensed premises so as to ensure that these conditions are fulfilled. In addition, the municipality performs the general duty of lifting garbage and keeping the city clean. The hotels and restaurants impose an additional burden on the municipality in this respect by

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63. *State of Tripura v. Sudhir Ranjan Nath,* (1997) 3 SCC 665, 673 : AIR 1997 SC 1168.
Also see, *P. Kannadasan v. State of Tamil Nadu,* (1996) 5 SCC 670; *State of Uttar Pradesh v. Sitapur Packingwood Suppliers,* (2002) 4 SCC 566 : AIR 2003 SC 2165.

64. *Commissioner & Secretary to Govt., Commercial Taxes and Religious Endowment Dept. v. Sree Murugam Financing Corp*., AIR 1992 SC 1383 : (1992) 3 SCC 488.

65. (1997) 2 SCC 715 : (1997) 1 JT 625.

66. *Secunderabad Hyderabad Hotel Owners' Ass. v. Hyderabad Mun. Corp.,* AIR 1999 SC 635 : (1999) 2 SCC 274.

reason of the nature of their occupation. The fees in question was part of the general fund but it was earmarked for the purpose it was collected. Fees can be levied on a graded basis, it does not have to be a lump sum levy. But it ought not to be excessive. In the facts of the instant case, the Court found that the licence fees collected formed only a very small part of the total expenditure incurred by the municipal corporation and, hence, the fee imposed was not excessive.

The power to levy a tax or duty on industrial alcohol vests in the Centre. A State Government is not competent to levy a tax or duty on industrial alcohol. Nevertheless, the State is competent to levy a charge on manufacturers of alcohol to meet the cost of maintenance of excise staff to supervise manufacture, storage etc. of industrial alcohol so as to ensure that non-potable alcohol is not diverted and misused as a substitute for potable alcohol. Such a provision can be traced to the regulatory power of the State under entry 33, List III.[67]

The Supreme Court has considered the concepts of regulatory/compensatory fees recently in *B.S.E. Brokers Forum v. SEBI.*[68] SEBI is primarily a regulatory body as it is charged with the function of regulating the business in stock exchanges and other securities markets. Under the relevant statutory provisions, SEBI is authorised to levy a fee "for carrying out the purposes of the SEBI Act, and also for registration of stock brokers etc.

On the concept of regulatory fee, the Supreme Court has stated in *B.S.E.*:

> "… so far as the regulatory fee is concerned, the service to be rendered is not a condition precedent and the same does not lose the character of fee provided the fee so charged is not excessive. It is also not necessary that the services to be rendered by the collecting authority should be confined to the contributories alone….. if the levy is for the benefit of the entire industry, there is sufficient *quid pro quo* between the levy recovered and the services rendered to the industry as a whole."

The Court said further:

> "Once we come to the conclusion that the fee in question is primarily a regulatory fee then the argument that the service rendered by the Board should be confined to the contributories alone, cannot be accepted…. Once the levy is in public interest and connected with the larger trade in which the contributories are involved then confining the services only to the contributories does not arise."

In the instant case, the Court accepted the Board's contention that it can levy a composite fee comprising both, *viz.*, fee for carrying out its purposes, and fee for registration. The Court also found that the fee is not excessive keeping in view the multifarious regulatory functions of SEBI. On this point, the Court has observed :[69]

> "While examining the reasonableness of the quantum of levy, the same will not be done with a view to find out whether there is a correlationable *quid pro quo* to the quantum of levy, because… the *quid pro quo* is not a condition precedent for the levy of a regulatory fee. Such examination will have to be made in the context of the levy being either excessive or unreasonable for the requirement of the authority for fulfilling its statutory obligation."

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67. *Bileshwar Khand Udyog K.S. Mandali Ltd. v. State of Gujarat,* AIR 1992 SC 872 : (1992) 2 SCC 42. See, *supra*, Ch. X, Sec. F.
68. AIR 2001 SC 1010 : (2001) 3 SCC 482.
69. *Ibid*, at 1022.

The Court also noted that all fees collected would be credited to a separate fund and the amount is utilised solely towards the expenses incurred by the Board in performance of its duties mandated under the parent Act. Fee can be levied on the brokers making their annual turn-over as the basis to measure the levy. Because of this, the fee cannot be characterised as income-tax, or a turn-over tax, or even a fee on income, or a fee on turnover.

RECENT DEVELOPMENTS

The requirement of a 'broad co-relation' between the benefit conferred and fee imposed was too widely interpreted in some cases, and since all State revenues are presumably expended or at least are expendable only for the welfare of the nation or the State as a whole, this led to a blurring of distinction with the characteristics of a tax. The decision in *State of H.P. v. Shivalik Agro Poly Products*[70] illustrates this approach.

For execution of a mortgage deed, the plaintiffs were required to pay stamp duty and registration fees amounting in accordance with a notification issued under Sections 78 and 79 of the Registration Act by the State of Himachal Pradesh.They challenged the Notification issued by the State Government. The Trial Court, the District Judge and the High Court declared the notification dated 14-4-1969 issued by the State Government prescribing the registration fee to be null and void decreed the suit. The main ground on which the plaintiffs' suit was decreed was that there is a distinction between tax and fee, that the State had not led any evidence to show that the amount realised by way of registration fee was deposited under a separate head or that it was exclusively utilised for the maintenance of the Registration Department. Placing reliance upon the *Shirur Mutt case* the Courts below correctly concluded that the levy was a tax and not a fee and consequently the impugned notification was ultra vires the Registration Act.

The Supreme Court, contrary to earlier decisions, placed the onus on the plaintiffs to show that the overall amount received by the Government by way of fee from the Registration Department far exceeded the overall expenditure incurred in maintaining the said department.[71] More importantly the Court, overlooking Article 266(2) and Article 283 both of which speak of public funds other than the Consolidated Fund, held that in view of Article 226, "*any amount realised by way of fee by the Central Government or State Government has to be credited to the Consolidated Fund of India or of the State concerned, as the case may be, and will thus necessarily get merged in the public revenues and cannot be set apart".*[72] On these erroneous bases the Court set aside the decrees passed by the Courts below and said :

> "the view taken in Shirur Mutt case has undergone a considerable change by subsequent decisions of this Court. Moreover, having regard to the express language used in Article 266 of the Constitution, it is not possible for the State Government to keep the fee realised in a separate fund other than the Consoli-

70. (2004) 8 SCC 556, at page 560 : AIR 2004 SC 4393.

71. (*Ibid* at p. 568).

72. (*Ibid* at p. 565). This view was differed from In *T.N. Godavarman Thirumulpad (87) v. Union of India*, (2006) 1 SCC 1 at page 12 : AIR 2005 SC 4256, the Court upheld the constitutionality of a fund generated to protect ecology and provide for regeneration of forests saying that such a fund "cannot in the constitutional scheme of things be considered and treated as a fund under Article 266 or Article 283 or Article 284 of the Constitution" and that "neither Article 110 nor Article 199 and/or Article 294 or 195 would have any application" to such fund.

> dated Fund of the State. In view of the subsequent decisions of this Court, the views taken in the decisions relied upon by learned counsel for the plaintiff-respondents cannot be considered to be good law and they are hereby overruled".

This view was reiterated in a number of decisions.[73] Consequently State legislatures are able to raise revenues by way of fees without any of the fiscal discipline applicable to the imposition of taxes.[74] However, at the same time in another series of decisions the principles in *Shirur Mutt* were relied on and reaffirmed.[75]

The disparity in approaches was resolved by the Constitutional Bench in *Jindal Stainless Ltd. (2) v. State of Haryana*,[76] which held that:

> "When the tax is imposed as a part of regulation or as a part of regulatory measure, its basis shifts from the concept of "burden" to the concept of measurable/quantifiable benefit and then it becomes "a compensatory tax" and its payment is then not for revenue but as reimbursement/recompense to the service/facility provider. It is then a tax on recompense. Compensatory tax is by nature hybrid but it is more closer to fees than to tax as both fees and compensatory taxes are based on the principle of equivalence and on the basis of reimbursement/recompense."

Therefore, as the law stands if the regulatory measure is statutorily imposed, the enactment must broadly indicate proportionality between the compensatory tax sought to be levied to the quantifiable benefit. If the Act does not so indicate 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 a reimbursement/recompense for the quantifiable/measurable benefit provided or to be provided to its payer(s).

(b) VEND FEE

The term 'fee' is at times used for the amount charged by the State (through a licence or auction) for vending narcotics, opium or liquor. In this context, the term 'fee' is not used in the technical sense of a charge for some service rendered. Here the term 'fee' is used for the price of consideration which the government charges from the licensees for parting with its privileges, and granting them to the dealers.

As the State can carry on the business in question itself, such a charge is the normal incident of business trading.[77]

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73. See *State of Gujarat v. Akhil Gujarat Pravasi V.S. Mahamandal,* (2004) 5 SCC 155 at page 166 : AIR 2004 SC 3894; *Sona Chandi Oal Committee v. State of Maharashtra,* (2005) 2 SCC 345 : AIR 2005 SC 635; *Vijayalashmi Rice Mill v. CTO,* (2006) 6 SCC 763 : AIR 2006 SC 2897.

74. See *infra* under Section J.

75. *Jindal Stripe Ltd. v. State of Haryana,* (2003) 8 SCC 60 : (2003) 8 JT 62; *CCE v. Chhata Sugar Co. Ltd.,* (2004) 3 SCC 466 at page 483 : AIR 2004 SC 3005; *State of U.P. v. Vam Organic Chemicals Ltd.,* (2004) 1 SCC 225 : AIR 2003 SC 4650; *Calcutta Municipal Corpn. v. Shrey Mercantile (P) Ltd.,* (2005) 4 SCC 245 : AIR 2005 SC 1879; *Hardev Motor Transport v. State of M.P.,* (2006) 8 SCC 613 : AIR 2007 SC 839.

76. (2006) 7 SCC 241, at page 268 : AIR 2006 SC 2550; *Gupta Modern Breweries v. State of J&K,* (2007) 6 SCC 317 : (2007) 5 JT 619; *Mohan Meakin Ltd. v. State of H.P.,* (2009) 3 SCC 157 : (2009) 1 JT 599.

77. *Harshankar v. Dy. Excise and Taxation Commr.,* AIR 1975 SC 1121 : (1975) 1 SCC 737; *State of Uttar Pradesh v. Sheopat Rai,* AIR 1994 SC 813; *supra*; *Organon (India) Ltd. v. Collector of Excise*, AIR 1994 SC 2489 : 1995 Supp (1) SCC 53; *supra.*

(c) COURT FEES

In *State of Madras v. Zenith Lamps,*[78] considering the validity of levying court-fees, under entry 3, List II,[79] the Supreme Court ruled that court fees could be levied not for increasing general revenues but to meet the cost of administration of civil justice. The fees must have relation to the administration of civil justice. The State should not make any profit out of court-fees and that "there must be a broad correlationship with the fees collected and the cost of administration of civil justice."

The Court observed in *Zenith*: "But one thing the legislature is not competent to do, and that is to make litigants contribute to the increase of general public revenue. In other words, it cannot tax litigation, and make litigants pay, say, for road building or education or other beneficial schemes that a State may have. There must be a broad correlation with the fees collected and the cost of administration of civil justice".

The Court stated that the *ad valorem* principle though not an ideal basis for distribution of a fee, was yet not so irrational as to incur constitutional invalidity.

In this case, an increase in court fees by the State of Madras was challenged. As enough material was not on record to show how much money was spent on civil justice in the State, the Supreme Court remanded the case to the High Court to decide whether the impugned court-fees amounted to 'fees' or 'tax' on litigation and litigants. The Court also ruled that the fact that collections went to the Consolidated Fund was not in itself conclusive because under Art. 266 all revenue raised by the State has to form part of the Consolidated Fund of the State.[80]

In *P.M. Ashwathanarayaana Setty v. State of Maharashtra,*[81] the Supreme Court considered the question of constitutional validity of court-fees levied on an *ad valorem* basis. The main question involved was whether the *ad valorem* court-fee could be regarded as a 'fee' or a 'tax', inasmuch as the correlation between fee and the value of the services rendered by way of *quid pro quo* was not established. Another question was whether or not such a fee was hit by Art. 14 as being arbitrary.[82]

The distinction between 'fee' and 'tax' has been elaborated by the Supreme Court in many cases.[83] Describing the nature of fee, the Supreme Court said in the instant case:[84]

> "A fee is.........a charge for the special service rendered to a class of citizens by Government or Governmental agencies and is generally based on the expenses incurred in rendering the services."

The Court referred in this connection to what it had said in the earlier decision in *Zenith Lamps,*[85] *viz.*: that "there must be a broad correlationship with the fees

78. AIR 1973 SC 724 : (1973) 1 SCC 162.
79. *Supra*, Ch. X, Sec. E.
80. *Supra*, Ch. VI, Sec. F(iii).
81. AIR 1989 SC 100 : 1989 Supp (1) SCC 696.
82. *Infra*, Ch. XXI, Secs. B and C.
83. See, *Supra.*
84. AIR 1989 SC at 110.
85. *State of Madras v. Zenith Lamps,* AIR 1973 SC 724 : (1973) 1 SCC 162.

collected and the cost of administration of civil justice". After looking into the statements of receipts and expenses on the administration of justice, the Court concluded that the requisite correlationship between receipts from court-fees and expenses on the administration of civil justice was established.

The Court rejected the argument that there should be a ceiling on the payment of court-fees in a case otherwise there may be a case where a person may have to pay a very high amount of court-fees without consequently deriving an equivalent service. Rejecting the argument, the Court observed:[86]

> "The test of the correlation is not in the context of individual contributors. The test is on the comprehensive level of the value of the totality of the services, set-off against the totality of the receipts. If the character of the 'fees' is thus established, the vagaries in its distribution amongst the class, do not detract from the concept of a 'fee' as such, though a wholly arbitrary distribution of the burden might violate other constitutional limitation."

Thus, the Court ruled that the test of correlation is at the "aggregate" level and not at the "individual" level. The Court observed in this connection:

> "... when a broad and general correlation between the totality of the fee on the one hand and the totality of the expenses of the services on the other is established, the levy will not fail in its essential character of a fee on the ground alone that the measure of its distribution on the persons of incidence is disproportionate to the actual services obtainable by them".[87]

The Court also refused to accept the argument that the *ad valorem* principle of charging court-fees is violative of Art. 14. It may not be an ideal basis for distribution of the fee but at the same time it cannot be said to be so irrational as to incur any constitutional infirmity. "The presumption of constitutionality of laws requires that any doubt as to the constitutionality of a law has to be resolved in favour of constitutionality".

The State is in theory entitled to raise the totality of the expenses by way of fee. Any interference with the present yardstick for sharing the burden might in turn produce a yardstick less advantageous to litigants at lower levels. The Court however criticised levy of court fees at a stiff rate which operates harshly and almost "tends to price justice out of the reach of many distressed litigants."

While court-fees could not be used for general purposes there is no bar against using general revenues on administration of civil justice. While the Court did not strike down the law levying court fees, it did, however, direct the State to take steps to rationalize the court fee structure and gave suggestions for the purpose. One suggestion *inter alia* was to levy a nominal fee—not over 2-2½% on small claims.

In Maharashtra, while there existed a ceiling of Rs. 15,000/- on court-fees payable by a civil litigant, no such ceiling existed for court-fees payable on proceedings for grant of probate and letters of administration where *ad valorem* fees were required to be paid. The Supreme Court found this to be discriminatory *vis-a-vis* Art. 14.

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86. AIR 1989 SC at 117.
87. *Ibid*, at 116.

In Tamil Nadu, an *ad valorem* duty of 7½% on the total claim was chargeable on an appeal from the civil judge to the High Court on the question of increasing of the amount of compensation on the land of the appellant being acquired by the State. The provision was held valid as levying a fee and not a tax.[88]

In the instant case, the Court reiterated certain propositions which it had already expounded earlier in several cases. If the essential character of the levy is that some special service is intended as *quid pro quo* to the class of citizens which is intended to be benefited by the service, and a broad and general correlation between the amount so collected and the expenses incurred in providing the services is found to exist, then such levy would partake the character of a 'fee', irrespective of the fact that such special services for which the amount by levy of fee is collected incidentally and indirectly benefit the general public also. In order to establish the correlation between the amount recovered by way of 'fee' and the expenses incurred in providing the service they should not be examined so minutely or be weighed in golden scale to discern any difference between the two.

It is not necessary to ascertain the same with any mathematical exactitude for finding the correlation but the test would be satisfied if a broad and general correlation is found to exist and once such a broad correlation between the totality of the expenses on the services rendered as a whole, on the one hand, and the totality of the amount so raised by way of the fee, on the other, is established, it would be no part of the legitimate exercise in the examination of the constitutionality of the concept of the impost to embark upon its effect in the individual cases. If the aforesaid relation is found to exist in the levy of the fee, the levy cannot be said to be wanting in its essential character of a fee on the ground that the measure of its distribution on the persons or incidence is disproportionate to the actual services made available to them. The Court clarified that the correlation is not in the context of individual contributors. The test is to ascertain on a comprehensive basis keeping in view the value of the totality of the service, *qua* the totality of the receipts.

It is not necessary that the collection made through the levy of court-fees should exactly tally or correspond to the expenditure incurred on the administration of civil justice. The amount raised through court fee and the expenses incurred in administration of civil justice is not to be examined with exactitutde with a view to ascertain any accurate and arithmetical equivalence. The test is satisfied if a broad and general correlation is found to exist. Even if the collections are somewhat more than the expenditure on the service, the levy would not fail on that account because once it is established that the primary and essential purpose is the rendering of the specific service to the specified class, it is immaterial that the State has earned certain benefits out of it indirectly.

The Court however exhorted the State that it was under an obligation to render administration of justice to its subjects. Accordingly, the amount raised from the suitors should not normally exceed the cost of administration of justice. The State should not seek to enrich itself and levy court fees with a view to collect revenue for general administration. The total receipts from court fees should be such as by and large can cover the cost of administration of justice.

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88. *Secretary to Govt. of Madras v. P.R. Sriramulu,* AIR 1996 SC 767 : (1996) 1 SCC 345.

I. A COMPARATIVE VIEW OF TAXING POWERS IN OTHER FEDERATIONS

In the Federations of the U.S.A., Canada and Australia, no elaborate distribution of taxing powers has been attempted. The general pattern is that the Central Government in each country is authorised, subject to some restrictions, to levy any tax. On the other hand, powers of the constituent units are somewhat restricted. In the U.S.A., the States can levy any tax except duties of imports and exports. In Canada, the Provinces are debarred from levying an indirect tax, while in Australia the States cannot levy duties of customs and excises.

The following gives a comparative view as to how the power to levy some of the major taxes is divided between the Centre and the constituent units in the U.S.A., Canada, Australia and India.

Customs: In all these countries, customs duties are levied by the Centre. In the U.S.A., however, no export duty can be levied by any government.

Income Taxes: In the U.S.A., Canada and Australia, income tax can be levied concurrently by the Centre and the States. In India, the power to levy the tax is divided between the Centre and the States according as the income is non-agricultural or agricultural.

Sales Tax: In Australia only the Centre, while in the U.S.A. and Canada, both levels of government, can levy this tax. In India, States levy sales tax except on an inter-State sale which falls within the Centre's taxing purview.

Excise Duties: In the U.S.A. and Canada, the Centre as well as the units can levy this tax, although in Canada, the provincial taxing statute has to be framed in such a manner that the courts do not hold it as an indirect tax which the Provinces cannot levy. In Australia, the Centre and not the States may levy this tax.[89] In India, the field has been demarcated between the Centre and the States according to the commodity taxed; alcohol and narcotics fall to the States, and all other commodities fall within the exclusive Central competence.

Succession and Estate Duties: In the U.S.A., Canada and Australia, power to levy these duties rests with both, the Centre as well as the units. In India, the field is divided: agricultural property falls within the State purview, while the non-agricultural property falls within the exclusive Central sphere.

Land Revenue or Land Tax: In the U.S.A., the Centre may levy this tax subject to the proviso that it must be apportioned among the several States in the proportion of the population. This condition has in practice nullified the Centre's power to levy land tax and has reserved the power to levy the tax to the States. In Australia and Canada, both tiers of government may levy such a tax. In India, however, it belongs exclusively to the States.

In the U.S.A., Canada and Australia, there is no rigid separation of taxing powers between the Centre and the States and both may levy many similar taxes simultaneously on the same tax base. This has given rise to many acute problems of overlapping and multiple taxation in these countries.

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89. On excise duties see entry 84, List I and entry 51, List II, *supra;* and also, *infra,* Ch. XV.

Overlapping taxation arises when Central and State taxes operate simultaneously on the same tax base. Multiple taxation arises when several States levy similar taxes on one and the same tax base. The former is the result of vertical competition between the Centre and the States; the latter, the result of horizontal competition among the several taxing States. Accordingly, in the three Federations, in the areas of income-tax and succession duties, both the Centre and the States operate simultaneously creating problems of overlapping taxation so that a person has to pay a Central as well as a State tax on the same income or property.

Further, many States can simultaneously levy these taxes on the same base on the ground of *nexus*. For example, a resident of Connecticut (U.S.A) conducts business in New York. The State of New York can tax his income because it originates there; the State of Connecticut can tax the same income because its recipient resides there.[90] Such problems make tax administration costly and inconvenient for the tax-payers and many legal issues arise constantly. In fact, the situation was so complicated in Australia and Canada that during the period of the second world war, income-tax and estate duty were centralised, and the regional governments were compensated with grants.[91]

J. RESTRICTIONS ON TAXING POWERS

If any power to tax is clearly mentioned in List II, the same would not be available to be exercised by Parliament based on the assumption of residuary power, for, under the constitutional scheme, the power to legislate in respect of a matter including a residuary matter does not carry with it a power to impose a tax.[92]

The Constitution imposes few restrictions on the taxing powers of the Centre and the States. As already stated, States' power to levy taxes on profession and trade is restricted by Art. 276,[93] and their power to levy taxes on electricity is restricted by Arts. 287 and 288.[94] Besides, some restrictions have been imposed on the States' power to levy sales taxes.

A limited application of the doctrine of immunity of instrumentalities or intergovernmental immunity, the constitutional provisions guaranteeing freedom of trade and commerce,[95] and a few fundamental rights[96] control the taxing powers of the Centre and the States.

(i) RESTRICTIONS ON THE STATES' POWER TO LEVY SALES TAX

The States' power to levy sales tax[97] has been subjected to a few restrictions with a view to keep inter-State and international trade and commerce, and trade in the goods of special importance, free from haphazard State taxation.

90. *Guarantee Trust Co. v. Virginia*, 304 US 19; *International Harvester Co. v. Evatt*, 399 US 416 (1946).
91. *South Australia v. The Commonwealth*, 65 CLR 373; *Victoria v. The Commonwealth*, 99 CLR 575.
92. *State of W. B. v. Kesoram Industries Ltd.*, (2004) 10 SCC 201 : AIR 2005 SC 1646.
93. *Supra*, Entry 60, List II; *supra*, Sec. D.
94. *Supra*, Entry 53, List II; *supra*, Sec. D.
95. *Infra*, Ch. XV, headed as "Freedom of Trade and Commerce".
96. *Infra*, Chs. XXI—XXXIII.
97. Entry 54, List II, *supra*, Sec. D.

First, a State is debarred from levying a tax on inter-state sale or purchase.

Secondly, no State can tax a sale or purchase taking place outside the State.

Thirdly, a State is debarred from levying a tax on sale or purchase taking place in the course of import and export.[1]

Fourthly, Parliament is empowered to impose restrictions on State taxation of sale or purchase of goods of special importance.

Each of these restrictions may be discussed here.

(a) TAX ON SALE OR PURCHASE OF GOODS OUTSIDE A STATE AND IN INTER-STATE TRADE AND COMMERCE:

A federation, although divided into several constituent units, nevertheless, constantly strives to promote freedom of trade and commerce within the country in order to weld it into one economic unit. It therefore becomes necessary to regulate taxation of inter-State sale or purchase lest an indiscriminate State taxation may hamper free flow of trade and commerce from one State to another and thus jeopardise the economic unity of the country. The Indian Constitution seeks to regulate taxation of inter-State sale or purchase in two ways: negatively, by prohibiting a State from levying, and, positively, by empowering the Centre to levy, a tax on such sale or purchase.

A sale (or purchase) is composed of many ingredients, *e.g.*, existence of goods forming the subject-matter of a sale; agreement to sell; passing of the title or transfer of ownership in the goods; delivery of goods; payment of the price, *etc*. Each of these ingredients is essential to complete a sale. When all these ingredients take place within one State, the sale is completely intra-state and the State concerned has plenary power to tax the same. On the other hand, when all these ingredients take place outside a State, the sale is completely outside the State and it cannot levy any tax on it.

Difficulties, however, arise when these ingredients take place not in one but several States. Applying the doctrine of territorial nexus[2] in such a situation, each of these States may levy a tax on the sale making the ingredient happening there as the taxable event. For example, Tatas manufacture steel in Bihar but sell it in all other States. Bihar can tax the sale by the Tatas taking advantage of the fact of manufacture within its borders of the goods sold, while other States can tax the sales taking place within their jurisdiction. In this way, a sale whose ingredients touch several States could be subjected to multiple tax burden.

This is what actually happened in India before 1956. Acting on the principle of territorial *nexus*, the States picked out one or more ingredients constituting a sale and made it or them the basis of imposing liability for sales tax. This led to imposition of multiple taxation on a single interstate transaction by different States. As this situation was bound to adversely affect interstate trade and commerce, it became necessary to take some ameliorative steps, and devise some suitable formulae, to mitigate such a situation.

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1. These sales are not taxable by a State but they may be taken into account to compute the gross turnover of dealers requiring them to register themselves for purposes of payment of surcharge over the sales tax payable by them.

Hoechst Pharmaceuticals Ltd. v. State of Bihar, AIR 1983 SC 1019 : (1983) 4 SCC 45.

Also see, *infra*, footnote 22.

2. *Supra*, Ch. X, Sec. A.

Before 1956, Art. 286 had sought to avoid multiple taxation of sales by stipulating that a State could not tax a sale taking place outside the State or in the course of inter-State trade and commerce. A sale was regarded as falling within the State in which goods under it were delivered for consumption. Explanation to Art. 286(1) enacted that a sale was regarded as falling in the State where goods under it were delivered for consumption. Art. 286 was subject of judicial interpretation in *State of Bombay v. United Motors Ltd.*[3] The question related to the validity of a legal provision made by the State of Bombay, taxing a sale under which goods from outside were delivered in Bombay for consumption therein, though property in the goods passed outside Bombay.

The Supreme Court adopted the 'outside consumption' test and held that the exporting State could not tax a sale under which goods went to another State, and that it could be taxed only by the State in which the goods were actually delivered for consumption.[4] The word 'consumption' was interpreted broadly so as to envisage not only consumption by the actual purchaser himself but also distribution for eventual consumption within the State. No other State, except that of consumption, could tax a sale touching several States and, thus, multiple taxation of such a sale was avoided.

The delivery for consumption within the State was considered to be a point at which the tax could be levied on interstate sale. This meant that a sale under which a trader in State A got goods from a trader in State B could be taxed only by state A and not by State B if the goods were delivered in State A for consumption. If, however, goods were not delivered in a State for consumption, *e.g.*, when the goods were re-exported to another State, then the sale concerned could be taxed by the State in which property in the goods passed under it.[5]

This judicial view while avoiding multiple taxation of inter-State sales, nevertheless, created difficulties for the trading community. States resorted to the practice of taxing inter-State sales under which goods came to them for consumption, but placed the liability to pay the tax on out-of-the State dealers. This was done because of convenience of tax collection, but it was very inconvenient to a trader sending goods to several States as he could be taxed by all the States. He had, therefore, to acquaint himself with the taxing laws of all the States, produce his account books and file returns before all the taxing jurisdictions. Consequently, the matter was reagitated in *Bengal Immunity Co. v. State of Bihar*.[6]

A company in Calcutta, manufacturing drugs there, accepted orders there and then sent goods to Bihar. Bihar sought to make the company liable to its sales tax with respect to its sales to Bihar dealers, but the company objected to it. The Supreme Court overruling its view in the *United Motors* case now held that it was an interstate sale which could not be taxed by any State, not even by the State of consumption, because of the bar imposed by Art. 286 on taxation of a sale in the course of inter-State trade and commerce. Inter-State sale thus became immune from all State taxation. The Court adopted this view as it felt it to be necessary to ensure a free flow of trade and commerce and to protect the traders from undue harassment.

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3. AIR 1953 SC 252 : 1953 SCR 1069.
4. M.P. JAIN, JUSTICE BHAGWATI AND CONSTITUTIONAL LAW, 2 *JILI*, 31.
5. *Malayalam Plantations v. Dy. Commr, A.I.T.* AIR 1965 SC 161 : (1964) 7 SCC 391.
6. AIR 1955 SC 661 : (1955) 2 SCR 603.

A privileged position was thus created for inter-State trade and commerce at the cost of local trade because people could make purchases from other States and avoid local taxation. The financial position of the States was adversely affected. The matter was considered by the Taxation Enquiry Commission.

The recommendations of the Commission were as follows: while sales tax must continue to be a State source, the power and responsibility of the States must come to an end, and that of the Union should begin, when the sales tax of one State impinges administratively on the dealers and fiscally on the consumers of another State. Therefore, interstate sales tax should be the concern of the Union, but the revenue should devolve on the States.

Accordingly, to give effect to the recommendations of the Commission and to ensure that the interstate trade and commerce does not go absolutely tax-free and pays tax at least once, the Constitution (Sixth Amendment) Act, 1956, was enacted. The Amending Act made the following changes:

(1) It made taxation of interstate sales a Union matter by introducing entry 92A in List I.

(2) Entry 54 in List II, regarding sales taxation by the States was subjected to entry 92A of List I.[7]

(3) There was difficulty in identifying what was a sale 'outside' a State, or 'in the course of import and export', so as to debar a State from taxing any such sale. Therefore, Art. 286 was modified by addition of cl. (2) so as to enable Parliament to define these concepts.[8]

(4) The Sixth Amendment also amended Art. 269 by adding clause (g) to Art. 269(1) so as to assign the revenue arising from Central taxation of interstate sales to the States.[9]

(5) Cl. (3) was added to Art. 269 so as to authorise Parliament to formulate for determining when a sale or purchase of goods takes place in the course of interstate trade or commerce.[10]

The effect of the above-mentioned modifications is that the power to tax inter-State sale (or purchase) now belongs to the Centre and not to the States which are also debarred from taxing an 'outside' sale, [Art. 286(1)(a)], and what is an 'outside' sale or 'inter-State' sale are matters for Parliament to define under Arts. 286(2) and 269 (3) respectively.

(b) OUTSIDE SALE/INTER-STATE SALE

Accordingly, Parliament levied a tax on interstate sale or purchase by the Central Sales Tax Act, 1956. The object of the Act is to formulate principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce or outside a State.[11]

A sale or purchase of goods is deemed to take place in the course of inter-State trade or commerce if the sale or purchase—(*a*) occasions the movement of goods

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7. *Supra*, Sec. C.
8. See, *infra* Secs. (b) and (c) below.
9. See, *infra*, Sec. K(i).
10. For Art. 269(3), see, *infra*, Sec. K(i), under "Tax Sharing".
11. *Ashok Leyland Ltd v. State of TN* (2004) 3 SCC 1 : AIR 2004 SC 2836.

from one State to another;[12] or (*b*) is effected by a transfer of documents of title to the goods during their movement from one State to another.

The tax is levied by the Centre but the power to assess and collect the same has been delegated to the exporting State which retains the proceeds for its own use.[13] The purpose of the Central Act is thus not to collect revenue for the Centre but to regulate the rate, assessment and collection of tax on inter-State transactions of sale or purchase. By giving power of assessment to the exporting State, the difficulties created by the *United Motors case* are avoided as dealers exporting goods to other States can be assessed by their own State.

The Central Act also lays down the test to determine what is an 'outside' sale. It defines a sale inside a State and characterises the same as being outside all other States. Only an inside sale can be taxed by a State and not an outside sale. The test to ascertain an inside sale is the existence of goods within the State.[14] In this way, a sale or purchase the different ingredients of which occur in different States, is now located, by a fiction of law, in one State only—the State where the goods exist—and thus multiple taxation of such a sale is avoided.

By the Central Sales Tax (Amendment) Act, 2001 which came into force from 11-5-2002. Section 2(g) of the The Central Sales Tax Act, 1956 has been substituted by a new sub-section by which the definition of 'sale' has been widened to include the deemed sales defined by Article 366(29-A) of the Constitution. Consequently, Central sales tax may be levied on transactions involving transfer of property in the goods involved in the execution of works contract or transfer of the right to use the goods. Such transactions are also open to levy by two different States either as inter-State transactions or intra-State transactions.

The problem of multiple taxation of interstate sale or purchase does not arise in Australia as only the Centre and not the States can levy sales tax. In Canada, the Provinces can levy a sales tax payable by the ultimate consumer and the problem of multiple taxation does not arise.[15] The problem is rather acute in the U.S.A. The judiciary has made some attempts to avoid multiple taxation of inter-State commerce by invoking the commerce clause[16] and the due process clause[17]

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12. If delivery of the goods is given to the buyer and title passes to him within the State, subsequent export by him from the State does not make the sale inter-State as the sale was already completed before the movement of goods began.

Cement Marketing Co. v. State of Mysore, AIR 1963 SC 980 : (1963) 3 SCR 1; *STC v. State of Mysore*, AIR 1967 SC 585.

A sale is inter-State if there is a contract of sale preceding the movement of goods from one State to another and the movement is the result of covenant in the contract of sale, or is an incident of that contract; in order that a sale may be regarded as an inter-State sale, it is immaterial whether the property in the goods passes in one State or another.

Ballabhadas Hulaschand v. State of Orissa, AIR 1976 SC 1016 : (1976) 2 SCC 44; *Union of India v. K.G. Khosla & Co.*, AIR 1979 SC 1160 : (1972) 2 SCC 242; *Indian Oil Corpn. Ltd. v. Union of India*, AIR 1981 SC 446, 449 : 1980 Supp SCC 426. See also *State of Orissa v. K.B. Saha and Sons Industries (P) Ltd*., (2007) 9 SCC 97 : (2007) 6 SCALE 284.

13. *Infra*, Sec. K(i), under Tax-sharing.

14. Sec. 4 of the Central Sales Tax Act. Also ILI, *Inter-State Trade Barriers & Sales Tax Laws in India* (1962).

15. *Atlantic Smoke Shops Ltd. v. Conlon*, 1943 AC 550: See, M.P. Jain, *Taxing Powers in Canada*, 1955 *Vyavahara Nirnaya*, 125; *supra*.

16. This clause has been used to invalidate State taxation, as unreasonable impediment to inter-State commerce, when it subjects such commerce to the possibility of multiple burden.

of the Constitution, but the problem is too complicated to be solved only by the Judiciary. In India, however, a systematic attempt has been made to solve the problem as is clear from the above.

(c) EXPORTS AND IMPORTS

Foreign trade being of great importance to the national economy, it becomes necessary to protect it from indiscriminate taxation. Consequently, Art. 286(1)(*b*) bars a State from imposing a tax on sale or purchase of goods which takes place in the course of import of goods into, or export of goods out of, the territory of India.

Under Art. 286(2), Parliament may by law formulate the principles for determining when a sale or purchase of goods takes place in the course of import or export. Accordingly, under S. 5 of the Central Sales Tax Act, 1956, a sale or purchase is in the course of export or import if it occasions the export or import of goods out of, or into, India,[18] or the sale is effectuated by a transfer of documents of title to the goods,—(*i*) in case of export, after the goods cross, and (*ii*) in case of import, before the goods cross, the customs frontiers of India.

Purchases in a State by an exporter for the purpose of export, as well as sales in the State by an importer after the goods have crossed the customs barrier, are not within the exemption. But sale in the State by an exporter or importer by transfer of shipping documents while the goods are beyond the customs barrier are within the exemption. Thus, if an exporter A purchases goods from C, and then exports them to B, the sale between A and B which occasions the export is exempt from sales tax but not the one between A and C. Similarly, if an importer A purchases goods from a foreign supplier B, and then sells them to C, when the goods have crossed the customs barrier, the sale between A and B is exempt from tax but not that between A and C.

Whether a sale has occasioned the export or not is a question of fact to be decided in the context of each case. No single test can be laid down as decisive for determining the question. Generally speaking, "Where the export is the direct result of sale, the export being inextricably linked up with the sale so that the bond cannot be disassociated without a breach of the obligation arising by statute, contract or mutual understanding between the parties arising from the nature of the transaction, the sale is in the course of export."[19]

It is not within the scope of this book to discuss this matter in detail.[20] A few examples will suffice here:

(a) Pursuant to an agreement between the Governments of India and Pakistan, a company loaded coal in wagons consigned to East Pakistan. Bills were drawn in respect of the coal supplied in the name of the Deputy Coal Commissioner,

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17. This provision has been used to invalidate State attempts to tax an object outside the State borders.

18. *Travancore-Cochin v. Bombay Co. Ltd.*, AIR 1952 SC 366 : 1952 SCR 5552: *Travancore-Cochin v. SVC Factory*, AIR 1953 SC 333; *State of Mysore v. Mysore Spinning Co.*, AIR 1958 SC 1003 : (1975) 2 SCC 47; *East India Tobacco Co. v. State of Andhra Pradesh*, AIR 1962 SC 1733 : (1963) 1 SCR 747; *Mohd. Serazuddin v. State of Orissa*, AIR 1975 SC 1564.

19. *B.G.N. Plantations v. S.T.O.*, AIR 1964 SC 1752 : (1964) 7 SCR 706.

20. For details see, I.L.I., *Annual Survey of Indian Law*, under Sales Tax.

Calcutta, who was to realise the price of coal supplied to Pakistan. It was held that no sales tax could be levied as the sale of coal was in the course of export.[21]

(b) Sale of coffee by the Coffee Board to the registered exporters who were under an obligation to export the same was a sale for export but not in 'the course of export' and so was not exempt from sales taxation.[22]

(c) An importer supplied copper to the Central Government. For this purpose, he imported copper under import licences granted by the Government. The Supreme Court held that the movement of goods in the course of import was not occasioned by the contract of sale and it was not exempt from sales tax.[23]

(d) The State of Bihar levied a surcharge on sales tax payable by dealers whose gross turn-over in a year was 5 lac rupees or over. For this purpose, the turn-over of inter-State sale or purchase was also to be counted though the surcharge was payable only on the sales tax levied on intra-State sale and not on inter-State sale.

The Supreme Court held that the provision was not invalid under Art. 286. A State Legislature could for purposes of registration of a dealer and submission of returns of sales tax, include the transactions covered by Art. 286. The provision is not assailable so long as tax is levied on intra-state sales only.[24]

(d) GOODS OF SPECIAL IMPORTANCE

Article 286(3) lays down that a State law imposing a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, is to be subject to such restrictions and conditions in regard to tax so levied as Parliament may specify.[25]

A list of such goods is contained in S. 14 of the Central Sales Tax Act. The restrictions on taxation of sales of such goods as imposed in S. 15 of the Act are: a tax shall be levied only on the last sale or purchase inside the State; it shall be levied only at one stage, and at a maximum rate of 4% of the sale price of the commodity.

This clause was added to enable Parliament to restrict States' power to tax important raw materials. This was done on the recommendation of the Taxation Enquiry Commission which had suggested that some restrictions be placed to tax intra-state sales of raw materials produced therein, otherwise, the cost of the manufactured articles whether manufactured in the State producing the raw materials, or in another State, would increase. The manufactured goods are consumed mostly outside the State producing the raw materials, an increase in their cost due to the State taxation is of direct concern to the consumers in other States. Therefore, the Commission felt that it was necessary that such interstate sales be brought under the Central control.

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21. *N.A. Coal Co. v. C.I.T.*, AIR 1966 Cal. 629.

22. *Coffee Board v. Jt. C.T.O.*, AIR 1971 SC 870 : (1969) 3 SCC 349.

23. *Binani Bros. v. Union of India,* AIR 1974 SC 1510 : (1974) 1 SCC 459. But see, *K.G. Khosla & Co. v. Dy. Commr.,* AIR 1966 SC 1216 : 1966 (5) SCR 352; *Dy. Commr. v. Kotak & Co.*, AIR 1973 SC 2491 : (1974) 3 SCC 148.

24. *Hoechst Pharmaceuticals Ltd. v. State of Bihar*, AIR 1983 SC 1019, 1021, 1050 : (1983) 4 SCC 5.

25. *Satnam Overseas (Export) v. State of Haryana,* (2003) 1 SCC 561 : AIR 2003 SC 66.

(ii) INTER-GOVERNMENT TAX IMMUNITIES

As two tiers of governments having autonomous functions and taxing powers operate side by side in a federation, their operations are bound to cross and intersect at several points. A government at one level may exercise its powers in such a manner as to interfere with the working of the government at the other level. The doctrine of immunity of instrumentalities or inter-governmental immunity seeks to ensure that government at one level in a federation operates without unduly restricting the operations and instrumentalities of the government at the other level. Though the doctrine has general application, yet its most significant application is in the area of taxation. The doctrine of immunity restricts, to some extent, the taxing powers of the governments in a federation.[26]

(a) U.S.A.

The doctrine of immunity originated, as did the modern federalism, in the United States. It is not mentioned explicitly in the Constitution but is the result of judicial interpretation.

The doctrine rests on the postulate that in a federal polity, there ought to be inter governmental tax immunities between the Centre and the States. The U.S. Congress enacted a law incorporating a Bank and a State levied a tax on the Bank's operations. Holding the State law to be unconstitutional in *McCulloch v. Maryland*,[27] the Supreme Court expounded the doctrine laying down that the States had no power, by taxation or otherwise, to "retard, impede, burden or in any manner control, the operations of the constitutional law enacted by Congress to carry into execution the powers vested in the general government."

At this early stage in the constitutional development of the U.S.A, the purpose of the doctrine was to protect the Centre against the onslaughts on it by the States. The Centre was at the time in its formative stage and needed to be protected against hostile State action against it or its immunities. But, a few years later, applying the same principle on a reciprocal basis to protect the State instrumentalities from Central taxation, the Supreme Court held in *Collector v. Day*[28] that the Central Government could not tax the income of a State judicial official.

The doctrine of immunity was thus evolved to protect the autonomy of the National and the State Governments within their respective spheres from being encroached upon by each other. In the beginning, a very broad concept of immunity held sway. The judicial tendency was to carry the doctrine of exemption to rather extreme lengths so much so that not only the governmental instrumentalities as such, but even private persons in their dealings with a government in various capacities, such as, suppliers, contractors or creditors, were held immune from being taxed by the other government.[29] For example, a manufacturer of motorcycles was held not subject to the Federal excise tax on sales thereof with respect to sales to a municipality.[30]

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26. M.P. JAIN and S.N. JAIN, *Inter-governmental Tax Immunities in India*, 2 *JILI* 101. (1959-60).
27. 4 Wheat. 316 (1819).
28. 11 Wall. 113 (1870).
29. CORWIN, THE CONSTITUTION AND WHAT IT MEANS TO-DAY, 39 (1978).
30. *Indian Motor Cycle Co. v. U.S.*, 283 U.S. 570 (1931).

Eventually, however, the courts realised that the doctrine in such broad terms benefited private individuals more than the governments, that it unduly restricted governments' taxing powers and that it was creating a tax-free privileged class of people. Consequently, the courts re-examined the doctrine and curtailed its broad canvas. Without going into details, the present position of the immunity doctrine in the U.S.A. may be summarized as follows:

A discriminatory tax by one government on the activities of the other is invalid. A federal non-discriminatory levy imposing a substantial burden on the States, or interfering with the performance of their 'essential' or 'sovereign' functions is also bad.

A State function is not immunized from Central taxation if the burden will be absorbed by private persons.[31] Thus, State employees can be subjected to Central income-tax.[32]

Business activities carried on by the States can also be subjected to Central taxes. The reason being that motives of profit may lead the States into many business enterprises and to immunize these from federal taxation would seriously cripple its revenue raising capacity.[33]

The immunity to the States has thus come to be confined to functions of a governmental character.

As regards the Central instrumentalities, the immunity granted in their favour from State taxation is somewhat broader. The Congress can always confer immunity on any of its instrumentalities from State taxation under the 'necessary and proper' clause.[34]

Even if the Congress is silent, States cannot tax activities or the agencies of the Centre,[35] but burdens which are not 'substantial' are not barred. The States can therefore, tax the salaries of the Central Government employees as it only means an indirect burden on the government.[36] Similarly, a tax on persons dealing with government, like contractors, is not bad even though they pass on the economic burden to the government.[37]

(b) CANADA

In Canada, the courts have refused to apply the American doctrine of immunity.[38] Thus, immunity has been refused to the income of officials of one government from being taxed by another government.[39] But discriminatory taxes by one government against another cannot be levied, and a Province cannot destroy

31. *Wilmette Park District v. Campbell*, 338 U.S. 411.

32. *Helvering v. Gerhardt*, 304 U.S. 405; *Graves v. New York*, 306 US 466.

33. *South Carolina v. U.S.*, 199 U.S. 437; *New York v. U.S.*, 326 U.S. 572.

34. *Carson v. Roane Anderson Co.*, 342 U.S. 232; CORWIN, *op. cit*., 92, 277; *supra*, Ch. X, Sec. L.

35. *Cleveland v. U.S.*, 323 U.S. 329; *Mayo v. U.S.*, 319 U.S. 441., *United States v. Sales Tax Comm. of the State of Mississipi*, 421 U.S. 599 (1975).

36. *Graves v. New York*, 306 U.S. 466.

37. *Alabama v. King & Boozer*, 314 U.S. 1; *U.S . & Borg-Warner Corp. v. City of Detroit*, 355 U.S. 466 (1958); Grover, Tax Immunities on Federal Property, 1959 *Wisconsin* L.R. 167; Pierce, "Tax Immunity Should Not Mean Tax Inequity., *ibid*., 173; Van Cleve Jr., "State Rights and Federal Solvency", *Ibid.*, 190.

38. *Bank of Toronto v. Lambe*, 12 A.C. 575 (1878).

39. *Forbes v. Att. Gen. for Manitoba*, (1937) A.C. 260.

or sterilise the status and powers of a Dominion company, *e.g.*, a company incorporated under the Dominion law cannot be required to take out a licence from a Province to do business therein.[40]

Section 125 of the British North America Act expressly incorporates, to a limited extent, the principle of inter-governmental immunity insofar as it prohibits taxation of lands or property of one government by the other. This provision, it has been held, does not immunize Provincial imports of goods from Central customs duties.[41] A tax may also be levied on an owner of land leased to the Crown, or on a tenant of government land.[42] No tax can, however, be levied on a corporate body for occupying land when it is a servant or an agent to the Crown.[43]

(c) AUSTRALIA

To start with, the American doctrine of Immunity of Instrumentalities was held applicable in full vigour in Australia. Thus, a Central Government servant was held immune from State tax in respect of his salary.[44] State instrumentalities, like State railways, were held immune from Federal taxation.[45] This phase, however, came to an end with the *Engineers case* in 1920.[46]

The State of Western Australia claimed immunity from a Central law in respect of trading concerns owned and controlled by it. The High Court rejected the doctrine as it thought that otherwise the States could without limit encroach on the Commonwealth power simply by creating a governmental instrumentality. A pay-roll tax on all wages payable by an employer (including the States) was held valid in *Victoria v. Commonwealth*.[47] It, however, appears that the Commonwealth enjoys immunity from State legislation.[48] Discriminatory laws cannot, however, be made by one government against the other.[49]

Section 114 of the Commonwealth of Australia Act, 1900, restricts the Commonwealth and the States from levying taxes on the property of each other. This provision, it has been held, does not immunize State imports from the Central customs duty. The constitutional provision was held to apply to State property within the Commonwealth but the customs duty was levied on the act of import and not on property itself and so did not fall under Section 114.[50] The Commonwealth could not, as occupier of private property, become liable to a municipal tax laid on an occupier of land.[51]

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40. *John Deere Plow Co. v. Wharton,* (1915) A.C. 330; *Caron v. The King,* [1921] 2 AC 91; Bora Laskin, *Canadian Constitutional Law*, 742-747.

41. *Att. Gen. for Br. Col. v. Att. Gen. for Canada,* (1924) A.C. 222.

42. *Spooner Oil Ltd. & Spooner v. Turner Valley Gas Conservation Board,* (1933) S.C.R. 629; *City of Montreal v. Attorney-General for Canada*, (1923) AC 136.

43. *Regina Industries Ltd. v. Regina*, (1947) S.C.R . 345; Bora Laskin *op. cit.*, 742.

44. *D'Emden v. Pedder*, I CLR 19; *Deakin v. Webb*, 1 CLR 585; *Baxter v. Commissioner of Taxation*, 4 CLR 1087 (1906).

45. *The Railway Servants'* case. 4 CLR 488 (1906).

46. *Amalgamated Society of Engineers v. The Adelaide Steamship Co. Ltd.*, 28 CLR 129.

47. (1971) 122 C.L.R. 353.

48. *Commonwealth v. Cigamatic Pty. Ltd.*, (1962) 108 CLR 372.

49. *West v. Commissioner of Taxation*, 56 CLR 657; *Essendon Corporation v. Criterion Theatres Ltd.*, 74 CLR 1; *Melbourne Corporation v. The Commonwealth* (The State Banking case). 74 CLR 31.

50. *Att. Gen. of N.S.W. v. Collector of Customs,* 5 CLR 818.

51. *The Essendon Corp. case, supra,* footnote 49.

(d) POSITION IN INDIA

The scope of the Inter-governmental tax immunities in India is very restricted. Such immunities are dealt with mainly in Articles 285, 287, 288 and 289. The Indian Constitution does not import the broad and general doctrine of immunity of instrumentalities as understood in the United States beyond what can be derived from these constitutional provisions. Arts. 285 and 289 are discussed below. Arts. 287 and 288 have been discussed earlier.[52]

Article 285 : Exemption of Union Property from State Taxation

Article 285 debars a State from taxing Union property.[53] Art. 285(1) provides that the property of the Union shall be exempt from all taxes imposed by a State, or by any authority within the State, except to the extent Parliament may otherwise provide by law. It is clear from the expression "any authority within the State" used in Art. 285(1) that the Union property is exempt not only from "State taxation", but also from tax imposed by any other authority like a municipality. A municipality being a creature of the State cannot enjoy any larger power than the State itself.

Article 285 imposes a ban on State taxation of Central Government property, and there is no way in which a State Legislature can impose a tax on the property of the Central Government. Only Parliament can relax this ban to the extent it likes by making a law.

The word "property" has been used in Art. 285(1) in a "perfectly general sense" without any qualification and includes lands, buildings, chattels, shares, debts, everything that has a money value, and every kind of property—moveable, or immoveable, tangible or intangible.[54] Also, no distinction is made between the Union property devoted to commercial purposes or that used for governmental functions. Thus, the States cannot tax any property of the Union whatever the use it is being put to.

Article 298 which provides that the Central executive power to acquire, hold and dispose of property for any purpose falling outside the Parliamentary legislative sphere, shall be subject to the laws of a State, does not override Art. 285 because what is subjected to State laws is only the Central "executive power" and not "property".[55]

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52. *Supra*, Sec. D.

53. In the Constituent Assembly. a strong plea was made to subject Union property, especially the railway property, to taxation by the local government, on the ground that it renders such services to the property as sanitation, hygiene, conservancy, roads, lighting, fire-brigade, *etc*., and that the financial position of the local bodies was not happy.

Objection was, however, taken to the proposal on several grounds, *viz*: (1) theoretically, it was objectionable to conceive property of a person, who was not represented in an organisation, to be taxed by that organisation *ad infinitium*, (2) The taxing power of the local government depended on the statute passed by the State and it was not known what kind of taxes, and to what extent would a State empower the local government to levy.

The rigours of the exemption have been mitigated, however, by permitting the *status quo* to continue, and empowering Parliament to allow taxation of the Union property by passing a law to that effect, IX CAD, 1147-1160.

54. *Governor-General in Council v. Corporation of Calcutta*, AIR 1948 Cal. 116. Also, *The Corporation of Calcutta v. The Governor of St. Thomas School*, AIR 1949 FC 121.

55. *Infra*, Ch. XII; *supra*, Ch. III.

Parliament has enacted the Railways (Local Authorities Taxation) Act, 1941, under which the Central Government may by a notification make railway property liable to pay tax in aid of the funds of any local authority. This Act has been enacted in pursuance of Art. 285(1).[56] The proscription relates to tax and does not affect the liability of the Railways to pay fees levied by the local authorities for supply of water and maintaining sewerage systems.[57]

The immunity from State taxation applies to the Central Government and its departments, and not to incorporated companies in which that government has a controlling interest.[58] Now a days many public corporations and government companies have come into existence. The Government uses these bodies as tools to conduct commercial functions. Government has, generally speaking, controlling interest in such bodies. These bodies enjoy a sort of intermediate position between independence and complete accountability through a Minister to Parliament. Since each of these bodies is incorporated under the relevant law, such a body is regarded as a separate and distinct legal entity and not as a part of the government like a department. Thus, the government companies like the Hindustan Steel Private Ltd., and the Sindri Fertilizers and Chemicals Ltd., or public corporations, would not be immune from State taxation.

Even when the entire share capital of a company is subscribed by the Central Government, it does not mean that the company is owned by the government. Jurisprudentially a company incorporated under the Companies Act has a separate corporate personality of its own, distinct from that of the government, and is not identified with it. Therefore, it would not be immune from State or municipal taxes. A municipality can levy tax on lands and buildings owned by such a company.

Certain government companies incorporated under the Companies Act, the entire share capital of which was held/owned by the Government of India, claimed exemption from the State taxation under Art. 285(1). The Supreme Court rejected the plea holding that merely because the entire share capital is held or owned by the Government of India, it cannot be held that the companies themselves are owned by the Government of India. It was observed that the companies which are incorporated under the Companies Act have a corporate personality of their own, distinct from that of the Government of India and that the lands and buildings are vested in and owned by the companies whereas the Government of India only owns the share capital.[59]

Similar is the position of statutory corporations set up by or under statutes enacted by Parliament. Such a body is not regarded as a department of the Central Government. It has a separate personality. It is regarded as an instrumentality of

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56. *Union of India v. Sahibganj Municipality*, AIR 1973 SC 1185 : (1973) 1 SCC 676. Also see, *Union of India v. Purna Municipal Council*, AIR 1992 SC 1597 : (1992) 1 SCC 100.

57. *Union of India v. State of U.P.*, (2007) 11 SCC 324.

58. JAIN & JAIN. PRINCIPLES OF ADMIN. LAW, Ch. XXV (1986).

59. *Western Coalfields Ltd. v. Spl. Area Development Authority*, AIR 1982 SC 697, 705 : (1982) 1 SCC 125. Also see, *Electronics Corp. of India v. State of Andhra Pradesh*, AIR 1983 A.P. 239; *Electronics Corp. of India v. Secretary, Revenue Deptt., Govt. of A.P.*, AIR 1999 SC 1734 : (1999) 4 SCC 458; *Bhilai Steel Plant, Bhilai v. Special Area Development Authority, Bhilai*, AIR 1991 MP 332; *Mahanadi Coalfields Ltd. v. State of Orissa*, AIR 1994 Ori. 258.

the Central Government. The property owned by such bodies is not exempt from State taxation.[60]

The Board of Visakhapatnam Port Trust is constituted under the Major Port Trusts Act, 1963. It is a body corporate with perpetual succession. It can acquire, hold or dispose of property. The Central Government can supersede the Board. In that case, all properties vested in the Board would vest in the Central Government until a new board is reconstituted. It was argued that the board is not an absolute owner of the properties, only the management of the properties vest in the board and as the properties belong to the Central Government, and so they were exempt from State taxation under Art. 285. Rejecting the argument, the Court ruled that the properties vest in the Board and not in the Government. The board is not a department of the Government but is distinct from the Central Government and it cannot, therefore, claim exemption from State taxation under Art. 285.[61]

Similarly, it has been ruled that the International Airport Authority of India constituted by the International Airports Authority Act, 1971, is a distinct juristic entity having its own properties, fund and employees. It is a statutory corporation distinct from the Central Government. Accordingly, the property vested in the Authority are subject to municipal taxation. The Authority cannot invoke the immunity created by Art. 285(1) of the Constitution.[62]

The Union property has been immunized from all taxes "imposed by a State, or by any other authority within a State" if the following two requisites are fulfilled:

(1) the State tax is levied directly on property:[63] and

(2) such property is vested in the Central Government.

Under these principles there is no scope for considering the incidence of tax—whether falling on the government or the private individual—in adjudicating the validity of a State taxing statute. A State tax would not be invalid, even though it ultimately falls on the Central Government, if the above two conditions are not satisfied. Conversely, a tax would not be valid merely because its incidence falls on a private individual. What is material is to ascertain the object "on" which the tax is levied irrespective of its incidence and, for this purpose, the charging section in the taxing statute is to be looked into.[64]

A municipality or a municipal corporation is an 'authority within a State'. Therefore, the municipality is not competent to levy any taxes upon the proper-

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60. *Food Corporation of India v. Municipal Committee,* AIR 1999 SC 2573 : (1999) 6 SCC 74; *Central Warehousing Corp. v. State of Rajasthan,* AIR 1995 Raj 180; *Municipal Commissioner of Dum Dum Municipality v. Indian Tourism Development Corp.,* (1995) 5 SCC 251 : (1995) 5 JT 610; *Hotel Corporation of India v. State of J&K,* AIR 2001 J&K 36.

61. *Board of Trustees for the Visakhapatnam Port Trust v. State of Andhra Pradesh,* (1999) 6 SCC 78 : AIR 1999 SC 2532. Also see, *Paradip Port Trust v. Notified Area Council, Paradip,* AIR 1990 Ori. 145.

62. *International Airport Authority v. Municipal Corp. of Delhi,* AIR 1991 Del. 302; *Municipal Commr. of Dum Dum Municipality v. India Tourism Development Corpn.,* (1995) 5 CC 251 : (1995) 5 JT 610.

Similar is the position of the *Indian Tourism Development Corporation.*

63. *Director, Maintenance, Dept. of Telecom., Bangalore v. State of Karnataka,* AIR 1998 Kant 335.

64. *Corp. of Calcutta v. Governor of St. Thomas School, supra,* footnote 54.

ties of the Union of India. The Calcutta Maidan belonging to the Government of India was leased to the petitioners. A tax imposed by the Calcutta Corporation was held bad because the tax was imposed on the property of the owner, *i.e.*; the Government of India, and not on the interest of the occupier, though part of the tax was realised from him.[65]

No tax can be levied by a municipality on the property belonging to the Central Government even if it is being used for residential or commercial purposes. If the property belongs to the Union, no tax could be levied thereon by the State or municipality irrespective of its use. Art. 285 does not provide for the concept of use.[66]

A State tax can be levied on the interest of the lessee of Central Government property. A municipality cannot levy octroi on goods imported by railway for consumption by it within the municipal limits.[67] A State cannot levy road tax on the vehicles owned by the Central Government, or the railway which is only a department of the Central Government.[68]

But the Karnataka High Court has differed from this approach. The High Court has ruled that the levy of tax on motor vehicles belonging to the Central Government is not invalid as the tax is not levied directly on property but indirectly on the use of the vehicles. The High Court has emphasized that Art. 285 bars State tax levied directly on property of the Central Government. Thus, Art. 285 does not bar levy of excise duty as the taxable event in this case is not goods but manufacture thereof. A State can levy sales tax on goods sold to the Central Government as the taxable event in this case is not goods but the sale thereof.[69] This view can be said to have been affirmed by the Supreme Court[70] which has held that the States can levy sales tax on the supply of materials by the Union of India to its contractors.

Under Art. 285(1), it is open to Parliament to enact a law to abrogate the exemption of its property from State taxation. No such law has however been enacted so far. However, the Centre has issued a circular that service charges in respect of its properties shall be paid by it to local authorities and that it shall be treated not as a tax but as compensation. This circular has been held to be legally enforceable.[71] It is only a State tax on Union property which is bad. A State may levy a tax on the employees of the Central Government.

Under Art. 285 (2), *status quo* has, however, been maintained as regards taxes levied on the Central property immediately prior to the commencement of the Constitution by any authority within the State until Parliament provides otherwise. Art. 285(2) enacts that until Parliament by law provides otherwise, Art. 285(1) would prevent any authority within a State from levying any tax on any Union property to which such property was immediately before the commence-

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65. *Turf Properties v. Corp. of Calcutta*, AIR 1957 Cal 431.
66. *Union of India v. City Municipal Council*, AIR 2000 Kant 104.
67. *Union of India v. Bhusaval Municipal Council*, AIR 1982 Bom 512
68. *Union of India v. State of Punjab,* AIR 1990 P&H 183; *Union of India v. State of Rajasthan,* AIR 1991 Raj 96.
69. *Director, Maintenance, Dept. of Telecom, Bangalore v. State of Karnataka,* AIR 1998 Kant. 335.
70. *Karya Palak Engineer, CPWF v. Rajasthan Taxation Board*, (2004) 7 SCC 195 : AIR 2004 SC 4499.
71. *Food Corporation of India v. Alleppey Municipality*, AIR 1996 Ker. 241.

ment of this Constitution liable so long that tax continues to be levied in that State. Art. 285(2) does not permit levy of any tax by a State; it benefits an 'authority' within the State, such as, a municipal body.

The authority can reap the benefit of Art. 285(2) if two conditions are fulfilled, *viz*.:

(1) That it is 'that tax' which is being continued to be levied and no other;

(2) That the local authority in 'that State' is claiming to continue the levy of the tax.

"In other words, the nature, type and the property on which the tax was being levied prior to the commencement of the Constitution must be the same as also the local authority must be the local authority of the same State to which it belonged before the commencement of the Constitution".

Thus, according to Art. 285(2), the local authority in the same State should continue to levy the tax. When the local authority in one State was levying the tax on railway property before the Constitution, but that authority was then transferred to another State after the Constitution, it could not claim the benefit of Art. 285(2).[72]

Some railway property had been subject to house tax and water tax long before the commencement of the Constitution. In March, 1953, as a result of a fresh assessment, the amount of the tax was enhanced. Holding the enhancement to be valid, the Supreme Court stated that a variation in the quantum of tax based on an increase in the value of the property would be covered by the constitutional provision.[73]

Certain properties belonging to the Telephone Corporation, a private body, were being taxed by the Calcutta Corporation. In 1943, the Corporation was taken over by the Central Government, but the tax on properties continued to be paid. In 1951, the Union disputed its liability to pay the tax on the ground that the assessment of the tax on its properties during 1943-51 was illegal. It was held that even if the pre-Constitution assessment was unlawful, the Union was, nevertheless, liable to pay the tax after the commencement of the Constitution, for the tax was being paid in fact immediately before the Constitution, commenced.[74]

It is open to Parliament to enact a law and abrogate the right of the local authority to continue to levy the tax under Art. 285(2).

Article 289: Property and Income of the States and the Union Taxing Powers:

Article 289(1) limits the taxing power of the Union by exempting from its purview State property and income. Art. 289(1) declares that the "property and income of a State shall be exempt from Union Taxation". Thus, ordinarily, the income derived by a State both from governmental and non-governmental or commercial activities would be immune from Central taxation. The term Central taxation means all taxes which the Centre is empowered to impose.

72. *Union of India v. Bellary Municipality*, AIR 1978 SC 1803 : (1979) 2 SCC 1. Also see, *Union of India v. State of Punjab*, AIR 1990 P&H 183.

73. *Union of India v. Municipal Board, Lucknow*, AIR 1957 All 452.

74. *Corp. of Calcutta v. Union of India*, AIR 1957 Cal. 548. Also *see*, *Union of India v. Municipal Commr., Bhagalpur*, AIR 1959 Pat. 216.

However, under Art. 289(2), the business operations of a State, State property used or occupied for trade or business, or income accruing therefrom, may be taxed if Parliament so provides.[75]

The scheme of Art. 289 is that, ordinarily, the income derived by a State both from governmental or non-governmental or commercial activities is immune from Union taxation, provided the income is the income of the State. This general proposition flows from Art. 289(1), Then, Art. 289(2) provides an exception to Art. 289(1). The Centre is authorised to impose a tax in respect of the income derived by a State government from trade or business carried on by it, or on its behalf. This can be done by Parliament making a law.

In the U.S.A., great difficulty was felt in drawing a line between governmental and commercial functions of the State Governments.[76] Therefore, in India, instead of leaving this matter to the courts, power has been given to Parliament to draw such a distinction by legislation. Parliament can specify the trading activities of the State Governments making them liable to Union taxation.

The Supreme Court in *New Delhi Municipal Committee v. State of Punjab*[77] has taken the view that under Art. 289(2), removal of exemption is not automatic; it comes about only when the Parliament makes a law imposing taxes in respect of any trade or business carried on by a State Government and all activities connected therewith, or any property used or occupied for the purposes of such business as also the income derived therefrom. If any property—whether movable or immovable—is used or occupied for the purpose of any such trade or business, it can be denied exemption provided by Art. 289(1), but this denial can be only by way of a law made by Parliament.

The Court has also ruled that unless an activity in the nature of trade and business is carried on with a profit motive, it would not be a trade or business contemplated by Art. 289(2). Only where a trade or business is carried on with a profit motive, or any property is used or occupied for the purpose of carrying on such trade or business, that Art. 289(2) would be attracted.

Under Art. 289(3), Parliament has power to declare by law any class of trade or business as incidental to the ordinary functions of government, and it would then be immune from Union taxation. Art. 289(3) means that whatever trade or business is declared to be incidental to the ordinary functions of government, would cease to be governed by Art. 289(2) and would then be exempt from Union Taxation.

Article 289(3) is an exception to Art. 289(2). When a trade or business is declared by Parliament to be incidental to the ordinary governmental functions, it

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75. In the Constituent Assembly, objection was taken to the Centre taxing a State enterprise on the ground that it would place a heavy financial burden on the States which might retard country's industrialisation. But several arguments were adduced in favour of Central taxation, *e.g.*, Centre had heavy responsibilities and so it should be able to raise sufficient revenue; States might start a number of industries which though not financially successful might yet kill private enterprise: Parliament could exempt any specific State industry from taxation and so the arrangement was flexible, etc.

On behalf of the Centre, assurances were given that it would not tax any State-run public utility industry and that it would tax equally a State-owned industry and a similar Central industry, if any: *IX CAD*, 1161-71.

76. See, *New Yark v. United States*, 326 US 572 (1946).

77. AIR 1997 SC 2847 at 2900, 2901 : (1997) 7 SCC 339.

would cease to be governed by Art. 289(2) and it would then be exempt from Union Taxation. This provision derives support from the principles developed in America according to which State commercial operations have been held not to be immune from Central taxation.[78] In the U.S.A., however, it has proved difficult to determine which function is incidental to the ordinary functions of government as it has to be determined judicially. In India, this difficulty has been got over by giving to Parliament the power to declare any trade or business to be incidental to the ordinary functions of government.

The principles underlying Art. 285(1) also apply *mutatis mutandis* to the taxation of State property by the Union, subject to one difference, *viz.*, whereas Union property devoted to commercial functions is exempt from State taxation, such State property is not so exempt from Union taxation *ipso facto*, and Parliament can pass a law to impose tax on such property.

The Supreme Court has held by a majority, in an advisory opinion, that the Centre can levy customs duty on goods imported or exported, or an excise duty on goods produced or manufactured, by a State Government irrespective of whether or not it is used for purposes of trade or business.[79] The exemption under Art. 289 in favour of the State property from Union taxation does not extend to the levy of customs duty on State imports and exports. Similarly, the exemption does not extend to levy of excise duty on production of goods by the States.

The Supreme Court has opined that to exempt the exports or imports made by the States from customs duty would seriously impair the power of Parliament to regulate foreign trade by using its taxing powers. Similary, exempting manufacture or production of goods by States from Central taxation would adversely affect the Central power to regulate interstate commerce. Art. 289(1), the Court has held, bars Central taxes *directly* on property or income of the States and not those taxes which may *indirectly* affect, or are *in respect of*, income or property. The customs duty is a tax on 'import or export', and excise on 'production or manufacture' and none of these taxes is levied on property or income as such, and, therefore, none of these taxes fall within the purview of Art. 289(1).[80]

The majority opinion is in line with the views held in other federations.[81] Another factor which the Court has invoked in favour of its view is that as the Centre is under an obligation to share its revenue with the States,[82] its revenue raising capacity should not be impaired by interpreting the exemption in favour of the States broadly.

The Centre can impose a tax on income or property of State-owned companies or corporations because they have an entity separate from its shareholders and, accordingly, their property and income cannot be regarded as that of the concerned State. Exemption from Central taxation under Art. 289(1) extends only to

78. *Supra.*
79. The issue was decided by the Bench of the Supreme Court by a majority of 5 : 4.
80. *In re Sea Customs Act*, S. 20(2), AIR 1963 SC 1760. This was a reference made by the President to the Supreme Court under Art. 143, see, *supra*, Ch. IV, Sec. C. Also see, *Director, Maintenance Deptt. of Telecom, Bangalore v. State of Karnataka*, AIR 1998 Kant. 335.
81. *Supra.*
82. *Infra*, Sec. K(i).

the States and not to their instrumentalities. An instrumentality of a State is a different entity from the State itself.[83]

Further, companies are normally incorporated to carry on commercial functions and, under Art. 289(2), Parliament has power to tax the commercial undertakings of the States. It may be realized that granting tax exemption to State enterprises not only places them in a favoured position *vis-a-vis* private enterprise which is heavily taxed, but also adversely affects the tax raising capacity of the Centre.

In the case noted below,[84] the Supreme Court has ruled that income of a corporation is not the income of the State since the former is an independent legal entity and, hence, Art. 289(1) does not apply. In this case, the Andhra Pradesh State Road Transport Corporation was constituted under the Road Transport Corporations Act, 1950. Prior to the Act, road transport was a department of the Andhra Pradesh Government and was being run by it and, thus, the income from road transport was exempt from tax as income of the State Government. But, after the formation of the corporation, income-tax was levied on its income.

The corporation argued against the levy on the ground that under the Act, the net income of the corporation was to go to the State of Andhra Pradesh, and, therefore the income of the corporation was really the income of the State Government. The Supreme Court rejected this contention holding that the corporation has a personality of its own as it has a separate fund of its own; it can borrow funds from any source, can enter into contracts and own property. The Court held that the fact that the corporation is owned by the State Government, or that in all material particulars, the corporation's activities are controlled by the State, are of no consequence.[85]

The Supreme Court has given a broad interpretation to the term "Union taxation" in Art. 289(1). It embraces all taxes leviable by Parliament including levy of taxes under Art. 246(4) in the Union Territories. In *New Delhi Municipal Committee v. State of Punjab*,[86] the question was raised whether the property of the States situated in the Union Territory of Delhi would be exempt from taxation by the New Delhi Municipality because of Art. 289(1). A nine Judges Bench of the Supreme Court has ruled in the affirmative. The term "Union Taxation" in Art. 289(1) has been held to include taxation by the New Delhi Municipality. The Court has argued that so far as a Union Territory is concerned, Parliament is the only law-making body,[87] or a legislature created by it. There is distribution of legislative powers between Parliament and the State Legislatures but there is no such distribution with respect to the Union Territories. Therefore, the phrase "Union Taxation" in Art. 289(1) encompasses municipal taxes levied by municipalities in the Union Territories.

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83. *Andhra Pradesh State Civil Supplies Corpn. Ltd. v. I.T. Commr., Hyd.*, 1983 Tax L.R. 1564. For the concept of an instrumentality, see., *infra*, Ch. XX, Sec. C.

84. *A.P. State R.T. Corp. v. I.T.O.*, AIR 1964 SC 1486 : (1964) 7 SCR 17.
Also, M.P. JAIN AND S.N. JAIN, Inter-governmental Tax Immunities in India, 2 *JILI*, 101 (1960).

85. See *Adityapur Industrial Development Authority v. Union of India*, (2006) 5 SCC 100 : AIR 2006 SC 2375.

86. AIR 1997 SC 2847 at 2892-2894 : (1997) 7 SCC 339.

87. For "Union Territories", see, *supra*, Ch. IX.

The Court has ruled that the term "Union Taxation" "can and should be given the widest amplitude, allowing it to encompass all taxes that are levied by the authority of Parliamentary laws". The Court refused to limit it to those matters falling within Arts. 246(1). The Court saw "no reason why such a limiting principle must be read into the definition of the phrase 'Union Taxation'". Therefore, levy of taxes under Art. 246(4) ought to be covered by the term "Union Taxation". This means that the State property situated in the Union Territories would be exempt from taxes on property leviable by the Union or municipalities therein created by the Centre.

The Supreme Court has refused to apply the general doctrine of immunity of instrumentalities beyond the area laid down in Articles 285, 287, 288, 289. The most significant pronouncement on the subject is *State of West Bengal v. Union of India*.[88] The State of West Bengal challenged the competence of Parliament to enact S. 47 of the Coal Bearing Areas (Acquisition and Development) Act, 1957, which sought to empower the Centre to acquire State-owned coal bearing lands and rights over them. The main argument invoked against the Act was that the States had within their allotted field "full attributes of sovereignty" and, therefore, "exercise of authority by the Union agencies" which "trenches upon that sovereignty is void."

The Court held the Act to be valid by a majority. Referring to the historical processes, the Court pointed out that during the British period, India's administration was highly centralised and the Provinces were never treated as sovereign. Under the present Constitution, sovereignty vests in the people of India. Examining the structure of the Constitution, the Court declared that Parliament was not incompetent, on account of "some assumption as to absolute sovereignty of the States", to acquire State property by legislation for government purposes.

The Court also refused to apply the general doctrine of immunity of instrumentalities.[89] The Supreme Court specifically rejected the American doctrine of immunity of instrumentalities. SINHA, C.J., speaking for the majority ruled that the Privy Council had rejected the doctrine and held it inapplicable to the Canadian and Australian constitutions. The doctrine was equally inapplicable to India. Referring to entries in List I (22, 23, 24, 26, 27, 30, 32, 52, 53, 54, 56, 57), under which Parliament can directly legislate in respect of property in the States, the Court held that to deny to Parliament, while granting the extensive powers of legislation, power to legislate in respect of property situated within a State, and even of the State, would render the constitutional machinery practically unworkable. In the ultimate analysis, the matter is of legislative competence. The power under entry 42, List III,[90] which may be exercised by Parliament in respect of all property—private as well as State-owned and is meant for the effectuation of the entries in the Central List, is not incapable of being exercised in respect of property of the States, as there is no constitutional interdict against it. Power to legislate for the regulation and development of mines and minerals under the control of the Union (entry 54 List I)[91] would, by necessary implication, include the power to acquire mines and minerals.

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88. AIR 1963 SC 1241 : 1964 (1) SCR 371.
89. *Supra.*
90. *Supra.*
91. *Supra*, Ch. X, Sec. D.

SUBBA RAO, J., however, dissented from the majority view and enunciated a broader doctrine of immunity. He insisted that "the Indian Constitution accepts the federal concept and distributes the sovereign powers between the co-ordinate constitutional entities, namely, the Union and the States". "This concept implies that one cannot encroach upon the governmental functions or instrumentalities of the other, unless the Constitution expressly provides for such interference", and, in the instant case, "there is no provision which enables one unit to take away the property of another except by agreement". But this argument did not prevail with the majority.

This is a momentous pronouncement by the Supreme Court and strengthens the viability of the Indian federalism. The doctrine of State rights stands discredited even in the older federations where the States had enjoyed a much greater autonomy before the creation of the federation than the State rights in India. The State rights doctrine, if accepted, would have weakened the Central Government as the States in future could have claimed more and more rights and immunities as against the Central Government and, thus, weaken the constitutional fabric.

The extension of the doctrine of immunity of instrumentalities beyond what is envisaged by the Constitution was rightly rejected by the Court as the doctrine is running into heavy weather even in the country of its origin and has been rejected in other countries like Canada and Australia.[92] The Indian Constitution seeks to provide a federal structure with a strong bias towards the Centre.[93] This position should not be corroded by any process—whether of judicial interpretation or otherwise.

K. EXPEDIENTS TO CREATE FINANCIAL EQUILIBRIUM AT THE STATE LEVEL

The scheme of allocation of Centre-State taxing powers, though designed with many considerations in view—convenience, simplicity, economy and uniformity, yet fails to create an equilibrium between responsibilities and resources at the State level. Most of the expansive and lucrative sources of taxation lie with the Centre, *e.g.*, income-tax, corporation tax, customs and excises. Moreover, the Centre has the whole country to tap and can tax the taxing capacity existing anywhere in India. On the other hand, while the fiscal needs of the States are huge, because of their responsibility to provide for development, welfare and social service activities like education, housing, health, agriculture, etc., for which there is an insatiable demand in the country, their revenue raising capacity is cabined due to many reasons, some of which are:

(1) the economic conditions prevailing within their boundaries;

(2) the fact that they have to share their taxing powers with the local governments; and,

(3) by their taxing powers being somewhat inelastic.

Land revenue constitutes an important tax for the States and gives sizeable revenue to them at present, but its capacity for further exploitation is limited be-

92. *Supra*.
93. See, *infra*, Ch. XIV, Sec. H.

cause a large number of holdings are small and uneconomic. Also, if agricultural income-tax is to be used increasingly, the land revenue would have to go down in relative importance. Agricultural income-tax would be meaningful only if a State has large agricultural income which means a high level of agriculture, and not all States can raise appreciable revenue from this source.

Further, political and populist considerations also deter the States from fully utilising the taxable capacity of the agricultural economy. Excises on alcoholic liquors could give to the States sizeable revenue but because of the policy of prohibition this is not being exploited by them fully as a source of revenue. The States, are, therefore, left with only sales tax as the only flexible source of revenue which can be cultivated by them in depth.

The framers of the Constitution had themselves realised that the States' taxing powers would not enable them to raise adequate revenue to meet their needs. They also appreciated that in spite of its expansive and expensive responsibilities, Centre's taxing powers were flexible and it could rise sizeable revenue, and after meeting its own requirements could spare some funds for the States.[1] The framers, therefore, sought to augment the resources of the States and create an equivalence between their functions and resources by making elaborate provisions in the Constitution for transfer of a part of the Central Funds to the States. Two expedients, tax-sharing and grants-in-aid, have been devised for this purpose.

Before discussing the Indian scene, it may be worthwhile to have some idea of the developments in other Federations in area of fiscal relationship between the Centre and the regional governments.

In the U.S.A., the Constitution makes no provision for transfer of revenue from the Centre to the States. Nevertheless, under the force of circumstances, a pervasive system of conditional grants has arisen under which the Centre financially supports many State activities.[2]

In Canada, the system of grants to the Provinces is in vogue and with the centralisation of income-tax during the war, a kind of tax-sharing has also come to be adopted.

In Australia, Central revenue goes to the States in several ways, *e.g.*, through conditional grants, sharing of income-tax, fiscal need grants through the Commonwealth Grants Commission, and loans.

These three Constitutions were drafted in the *laissez faire* era. Gradually *laissez faire* gave way to the concept of social welfare which generated public demand for social services and this led to the emergence of the system of Central grants to the States to enable them to meet these demands.

There is another value which is now sought to be promoted to some extent in each federation, *viz.*, removal of regional disparities arising out of differences in economic and natural resources. While the taxing capacity of the people in a poor State is low, their needs are rather high and, therefore, to leave such a State to its own resources to provide services to the people would be to condemn the people

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1. REPORT OF THE EXPERT COMMITTEE ON FINANCIAL PROVISIONS, *VII CAD*, 59. Also, IX *CAD*, 203-343.

2. JAIN, Federal Grants-in-aid in the U.S.A., *supra*, note 53, on 823.

to remain in a backward situation. To avoid this, the Central Government seeks to transfer funds to the States in such a way that even a poor State is able to provide social services to its own people at a level comparable with the rich States. Not to do so would generate disaffection among the various States which may generate tensions in the country. While this process of equalization is at work in some way in all federations, it has been taken farthest in Australia through the operation of the Commonwealth Grants Commission[3] and giving of grants to the States as their share of the income-tax revenue.

(i) TAX-SHARING

The Indian Constitution provides for a scheme of Centre-State tax sharing on a big scale. This envisages that the Centre shares some of the taxes levied and collected by it with the States. All revenue accruing to the States from their taxes is used by them, but all taxes leviable by the Centre are not meant for its exclusive use. The Centre is required to share some of its taxes with the States.

The powers of taxation assigned to the Union are based mostly on considerations of convenience of imposition and collection and not with a view to allocate them solely to the Union. The constitution-framers did not intend that all taxes assigned to the Centre should be solely spent by the Centre for its own purposes. They desired that a part of the Central revenue arising from taxation be used for subsidising the State activities.

(a) SCHEME EXISTING BEFORE 2000[4]

From the point of view of tax-sharing, all Central taxes were arranged in the following five categories.

1. Taxes levied and collected by the Centre, and used by it as a whole.

These taxes were: customs, corporation tax, capital gains tax, surcharges on taxes mentioned in categories (2) and (4) below [Art. 271], and residuary taxes.[5]

2. Taxes levied and collected by the Centre, but the net proceeds[6] of which had to be *compulsorily* shared by it with the States. [Art. 270].

The tax on non-agricultural income (excluding corporation tax) fell in this category. The Centre had to hand over a part of the revenue accruing to it from the levy of income tax to the States.

Such percentage, as 'may be prescribed', of the net proceeds of this tax in a financial year, except the proceeds attributable to the Union Territories, or to taxes payable in respect of Union emoluments,[7] was to be distributed among the States in such manner as was to be 'prescribed'. This divisible pool of the income-tax did not even form part of the Consolidated Fund of India.[8]

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3. Also see, *infra*, Sec. L.
4. For the new scheme of tax-sharing after the year 2000, see, *infra*, (b).
5. *Supra*, Secs. C and G.
6. The term 'net proceeds' means the proceeds of a tax minus the cost of collection. The net proceeds of a tax are to be ascertained and certified by the Comptroller and Auditor-General of India, whose certificate is final: Art. 279.
7. 'Union emoluments' include all emoluments and pensions payable out of the Consolidated Fund of India on which income-tax is charged: Art. 270(4)(*c*).
8. *Supra*, Ch. II, Sec. J(ii)(g).

The word 'prescribed' here meant prescribed by the President by order after considering the recommendations of the Finance Commission.[9] Parliament need not pass a law for the purpose. This technique had been adopted as it was feared that there might be a good deal of wrangling in Parliament if the matter were to be discussed there and there might be undue political pressures for favouring one State at the cost of another State, and the big States having a large number of representatives in Parliament might combine to do injustice to the smaller States.[10]

Under Art. 271, the Centre could levy a surcharge on income-tax on non-agricultural income for its exclusive use without sharing it with the States [see category I above].

3. Taxes levied and collected by the Centre but a portion of the net proceeds of which '*may* be assigned' by it to the States by its own law [Art. 272].

The Central excises (other than on medicinal and toilet preparations) fell in this category. Unlike the income-tax which *must* be shared, Centre-State tax-sharing in this area was not compulsory but *optional* for the Centre. The revenue accruing from the Central excises formed part of the Consolidated Fund of India out of which payments were to be made to the States when Parliament passed a law for this purpose.

4. Taxes levied and collected by the Centre, but the whole proceeds of which belonged to the States [Art. 269(1)].

The taxes falling in this category were:

(*a*) duties of succession on property other than agricultural land;

(*b*) estate duty in respect of non-agricultural property;

(*c*) terminal taxes on goods or passengers carried by rail, sea or air;

(*d*) taxes on railway fares and freights;

(*e*) taxes other than stamp duties on transactions in stock exchanges and futures markets;

(*f*) taxes on the sale or purchase of newspapers and on advertisements published therein;

(*g*) taxes on the sale or purchase of goods other than newspapers in the course of inter-State trade or commerce [see entry 92A List I];

(*h*) taxes on the consignment of goods (whether the consignment into the person making it or to any other person), where it takes place in the course of inter-State trade or commerce, (entry 92B, List I).

The net proceeds in a financial year of these taxes, except the proceeds attributable to the Union Territories, did not form part of the Consolidated Fund of India, but were distributed among the States in accordance with the principles formulated by law by Parliament [Art. 269(2)]. No part of the revenue arising from the taxes mentioned in this category was to be kept by the Centre.

As already noted above, the Centre could levy a surcharge on any of these taxes for its own purposes, which was not divisible among the States [Art. 271].

9. For Finance Commission, see, *infra*, Sec. L.
10. *IX CAD* 212.

With reference to (g) and (h) above, Art. 269(3) of the Constitution authorised Parliament by law to formulate principles for determining when a sale or purchase of, or consignment of, goods took place in the course of inter-State trade or commerce. In exercise of this power, Parliament enacted s. 3. of the Central Sales Tax Act, 1956, laying down the principles todetermine when a sale or purchase of goods took place in the course of inter-State trade or commerce so as to be liable to the Central sales tax imposed under Art. 269(1)(g).[11]

It had been held that a State possessed no competence to impose a tax on mere despatch of goods by a manufacturer to his own branch outside the State. It was held that this could not be regarded as a sale or disposal of goods and, therefore, it would not fall within the ambit of entry 54 of List II. Such a tax would fall within the Parliamentary field of legislation in the residuary field by virtue of Art. 248 and the residuary entry No. 97 of List I. Now, under Art. 269(1)(h) along with entry 92B, such a tax fell exclusively within Parliamentary field and a State Legislature could not intrude into the Parliamentary field.[12]

5. Taxes levied by the Centre but collected and utilised by the States [Art. 268].

Taxes like stamp duties and duties of excise on medicinal and toilet preparations fall in this category. Proceeds from these duties, except those collected by the Government of India for the Union Territories, do not form part of the Consolidated Fund. The States themselves collect the duties, though under a Central law, and appropriate them for their own purposes.

These taxes have been placed within the Central sphere merely for legislative purposes so that there may be uniformity in the rates of taxation throughout the country, and also that the Centre may co-ordinate these excises with its own wider scheme of excises on other commodities.

Under the Central Sales Tax Act, the tax on the sales in the course of inter-State trade and commerce is levied by the Centre but is assessed, collected and used by the exporting State.

(b) COMMENTS

The above scheme appreciably augmented the tax resources of the States and correspondingly curtailed those of the Centre. The exclusive Central tax resources were:

(*a*) taxes levied, collected and appropriated by the Centre (category I above); and

(*b*) taxes levied and collected by the Centre but shared with the States either compulsorily or voluntarily (categories 2 and 3 above).

However, the Centre had power to levy surcharges on some of the taxes (see 2 and 4 above) for its own purposes and not share them with the States although the basic tax revenue had to be shared. During an emergency, the Centre can further augment its tax resources.[13]

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11. See, *supra*, Sec. J(i)(b).

12. *Goodyear India Ltd. v. State of Haryana,* AIR 1990 SC 781 : (1990) 2 SCC 71.

Art. 269(1)(h) and entry 92B have been added by the Constitution (Forty-Sixth Amendment) Act, 1982. For the Amendment, see, Ch. XLII, *infra.*

13. *Infra*, Ch. XIII.

The State tax resources were:

(*a*) taxes levied and collected by them (all taxes enumerated in List II);

(*b*) taxes levied by the Centre but collected by them (category 5 above);

(*c*) taxes levied and collected by the Centre, the whole of the proceeds of which belonged to the States (category 4 above);

(*d*) taxes levied and collected by the Centre but voluntarily shared with them (category 3 above) and

(*e*) taxes levied and collected by the Centre but compulsorily shared by it with the States (category 2 above).

The Constitution had devised a flexible and elaborate scheme of tax-sharing.

Article 274 lays down that none of the following Bills or amendments is to be introduced or moved in a House of Parliament except on the President's recommendation:

(1) a Bill imposing or varying a tax in which the States are interested, *i.e.*, a tax from the proceeds of which the States get a share;

(2) a Bill varying the meaning of the expression 'agricultural income' as defined for purposes of the Indian income tax law;[14]

(3) a Bill affecting the principles on which, under the provisions of the Constitution (Arts. 268-273), moneys may be distributable to the States; and

(4) a Bill imposing a surcharge on a tax for Central purposes.

As noted above, Parliament has power, under Art. 271, to levy a surcharge on taxes mentioned in Arts. 269 and 270. Revenues arising from surcharges are not shared by the States. The effect of Art. 274, therefore, is that a Bill of the type mentioned therein can be moved only by or with the consent of the Central Government. The advantage of this is that when once an allocation of funds has been made to the States, it cannot be disturbed by a private member bringing in a Bill for the purpose.

NEW SCHEME OF TAX-SHARING AFTER 2000

There was a major reconstruction of the scheme of tax-sharing between the Centre and the States in the year 2000.

Till the year 2000, only a few Central taxes were shareable between the Centre and the States. The Tenth Finance Commission suggested that the present system be replaced by a new scheme in which the States shared in the total tax revenue of the Centre. The Commission also suggested that the share of the States in the gross receipts of Central taxes be fixed at 26% and that this ratio be reviewed after 15 years.

The Commission saw many advantages in the new proposed scheme, as for example : the States can share in the aggregate buoyancy of Central taxes; the Central Government can pursue tax reforms without the need to consider whether a tax is shareable with the States or not; the impact of fluctuations in Central tax

14. *Supra.*

revenue would be felt alike by the Central and State Governments.[15] At present, if the Centre needs more revenue for its own needs, it has to take recourse to non-shareable taxes which distorts the pattern of Central taxation. This distortion will be avoided by the proposed scheme. But, inevitably, to introduce the proposed scheme, the Constitution would have to be amended.

Consequent upon the suggestion made by the Tenth Finance Commission, as stated above, to orient the system of tax-sharing between the Centre and the States Parliament has enacted the Constitution (Eightieth Amendment) Act, 2000. This Amendment has altered in a fundamental manner the pattern of sharing of Central taxes with the States which had been prevailing hitherto and which has been described above.[16]

In 2003 Article 268-A was introduced in the Constitution by the Constitution (Eighty-eighth Amendment) Act, 2003, which provides that taxes on services shall be charged by the Union of India and shall be appropriated by the Union of India and the States.

A new Art. 270 has been substituted for the old one. The new Article [(270(1)] provides that the net proceeds of all taxes and duties referred to in the Union List, except the following, levied and collected by the Centre shall be distributed between the Centre and the States. The exceptions to this are:

(1) Duties and taxes referred to in Arts. 268, 268-A and 269 respectively;

(2) Surcharge on Taxes and duties referred to in Art. 271;

(3) Any cess levied for specific purposes under a law made by Parliament.

The new Article 270 does not fix the percentage of the net proceeds of the Central taxes which must be distributed among the States. Art. 270(2) merely says "such percentage as may be prescribed". In practice, the prescription of the distributable percentage of the Central taxes has been left to be settled to the Finance Commission.

The Eleventh Finance Commission has fixed this percentage at 29.5%. Thus, 29.5% of the Central Tax revenue has to be transferred to the States. The Commission has also worked out the scheme of *inter se* distribution of this tax revenue among the various States keeping in view a number of considerations, such as, population, collection, State budgetary deficits, State effort to improve its resource base, economy in State administration, fiscal discipline.

The 12th Finance Commission Report (2005-2010) raised the share of States in shareable Central taxes from 29.5 per cent to 30.5 per cent, the total transfers recommended being higher by 73.8 per cent over those recommended by the Eleventh Finance Commission.[17]

Article 269 has also been recast by the 80th Amendment. The new Article includes two taxes now, *viz.*, taxes on the sale or purchase of goods in the course of inter-state trade or commerce; taxes on consignment of goods in the course of

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15. REPORT OF THE TENTH FINANCE COMMISSION, 59-61 (1994).
16. For this Amendment, see, Ch. XLII, *infra*.
17. On November 14, 2007 the Thirteenth Finance Commission was constituted under Article 280(1) of the Constitution. Its recommendations will cover the period of five years from Ist April, 2010 to 31st March 2015 to be submitted by 2009.

inter-State trade or commerce. These two taxes are levied by the Centre but are assigned as a whole to the States. Art. 272 has been repealed.

The new scheme of tax sharing is simple as all, and not a select few, Central taxes are shared between the Centre and the States. The scheme is designed to enable the states to share the aggregate buoyancy of the Central taxes. It will also enable the Centre to pursue its programme of tax reforms without being bothered as to whether a tax is sharable or not with the States.

The revenue transferred to the States by way of tax-sharing is unconditional which they use as they like. Thus, the major burden of taxation falls on the Centre while the States enjoy a part of the fruits of its efforts. Politically and economically, the Centre is in a much stronger position to tax than the States are. From the State point of view, the disadvantage of the scheme may be that they do not have control over the level of taxation, and they do not enjoy flexibility of varying the rates of taxation to suit their needs, as they could have done had the taxes been in their own legislative domain. But, as the situation exists today, the rates at which the Centre is levying these taxes are pretty high and it is very doubtful if the States could have collected as much revenue themselves from these taxes as they secure now as their share from the Central levy. Besides, many advantages which arise out of separating the Centre-State taxing powers have already been noted earlier.[18]

The fact however remains that in spite of the higher devolution of funds from the Centre, the financial position of the States is none-too-happy. Practically all States run deficit budgets and indulge in huge borrowing.

Although the Constitution devises an elaborate and flexible scheme of Centre-State financial relationship, and also that larger and larger Central funds have been devolving on the States over time, the fact remains that the present day financial health of the States is none too happy. Several factors have contributed to this situation, such as, the States do not make adequate tax effort; their tax collection machinery is weak; the demands of planning have cast a shadow over their resources. The States indulge in populist, but economically unsound, schemes which increase their budget deficit. For example, they do not charge economic rates from some favoured sections of consumers for the services provided by them. For example, in spite of huge investments made in generation of electricity, the States incur heavy losses instead of getting any return from their investment.

The Tenth Finance Commission has observed in this connection:[19]

> "We are painfully conscious of the fact that most States have preferred the softer option of letting services deteriorate rather than improving their spread and quality by realising economic returns on the investment in these areas and deploying the additional resources for this purpose."

Certain fiscal improvements have been sought to be evolved by enactment of fiscal responsibility legislations by the Centre and 26 State Governments. The Fiscal Responsibility and Budget Management Act was enacted by the Central Government in 2003 to reduce revenue and fiscal deficit. All the State Governments, barring West Bengal and Sikkim, have enacted Fiscal Responsibility Acts

18. *Supra.*
19. REPORT OF THE TENTH FINANCE COMMISSION, 9

to phase out their revenue deficits and bring down their fiscal deficits to 3 per cent of GSDP by 2008-09.[20]

(ii) GRANTS-IN-AID

Apart from the scheme of tax-sharing as mentioned above, another expedient used to effect transfer of revenue from the Centre to the States is the system of grants-in-aid. The Constitution envisages and provides for several forms of grants.

(a) FISCAL NEED GRANTS

Article 275 makes provision for 'fiscal need' grants. Parliament is authorised to provide by law as grants-in-aid to the revenues of such States as Parliament determines to be in need of assistance; and different sums may be fixed for different States.

These grants are fixed by Parliament every five years on the basis of recommendations of the Finance Commission.[21] These grants are given not to each State but only to such States as may be in need of assistance. The amount of money payable to the States by way of fiscal need grants is also unconditional and the recipient States can use this money as they like.

(b) SPECIFIC PURPOSE GRANTS

In common with other Federations, a system of grants oriented to promoting specific State activities and programmes, is also in operation in the country. These grants are known as 'conditional grants' or "specific purpose grants". These grants are given at the discretion of the Centre for supporting such activities as the Centre may wish to promote to achieve the desired national goals.

A few such grants are prescribed by the Constitution itself, *viz.*, Art. 275(1) requires the Centre to make grants to a State to enable it to meet costs of schemes of development undertaken by it with the approval of the Central Government, for promoting the welfare of the Scheduled Tribes, or for raising the level of administration of the Scheduled Areas in the State.[22]

A Central grant is payable to Assam equal to the average excess of expenditure over the revenues during the two years preceding the commencement of the Constitution in respect of the administration of Tribal Areas in that State,[23] and the cost of such schemes of development as may be undertaken by the State with the approval of the Centre for raising the level of administration of these areas.[24]

The most important provision for conditional grants, however, is Art. 282 which has been discussed later.[25]

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20. Report submitted to the Prime Minister on July 30, 2008 by the Economic Advisory Council to the Prime Minister: II.2.

21. *Infra*, Sec. L.

22. *Supra*, Ch. IX, C; *infra*, Ch. XXXV.

23. *Ibid.*

24. *Proviso* to Art. 275(1).

25. *Infra*, Sec. M.

L. FINANCE COMMISSION

After providing for the taxes which the Centre *shall* or *may* share with the States, and for fiscal need grants from the Centre to the States, the Constitution desists from laying down any rigid formula to determine the specific amounts payable to the States by the Centre under each head.

The Constitution-framers realised that a 'permanent' or immutable formula would hardly meet the situation for all time to come as changes in socio-economic conditions in the country would demand constant adjustment in the basis of transfer of revenue from the Centre to the States. They, therefore, devised a flexible scheme for transfer of Central revenue to the States, a scheme adjustable in the light of experience, contemporary economic situation, and financial position of the Centre and the States; and reviewable periodically, and which should work automatically without causing any inter-governmental friction. In this approach, they were fortified by the experiences of Canada and Australia where the formula laid down in the respective constitution for Central grants to the units soon proved to be inadequate and new bases had to be evolved from time to time for the purpose.

The above mentioned objectives were achieved by making provisions in the Constitution for a periodic appointment of a Finance Commission, a 'non-political' body, and by leaving it the task of making inter-governmental financial adjustments from time to time.

Article 280(1) provides for the appointment by the President of a Finance Commission every five years, or earlier, if he considers it necessary. The Commission is to consist of a Chairman and four other members appointed by the President. Under Art. 280(2), Parliament is empowered to determine by law the requisite qualifications for appointment as members of the Commission.

Accordingly, the Finance Commission (Miscellaneous Provisions) Act, 1951, has been enacted by Parliament. The Chairman of the Finance Commission is to be a person having experience in public affairs. Its other four members are to be selected from among persons qualified to be appointed as the High Court Judges, having special knowledge of government finances and accounts, having wide experience in financial matters and administration, or having special knowledge of economics.

A person is disqualified to be appointed as a member of the Commission if he is of unsound mind, is an undischarged insolvent, has been convicted of an offence involving moral turpitude, or has financial or other interests prejudicially affecting his functions as a member of the Commission.

Article 281 lays down that the President shall cause every recommendation made by the Finance Commission together with an explanatory memorandum as to the action taken thereon, to be laid before each House of Parliament.

The functions of the Commission, as prescribed by Art. 280(3), are to make recommendations to the President with regard to the following matters:

(*a*) The distribution between the Union and the States of the net proceeds of the taxes which are to be, or may be, divided between them and the allocation of the respective shares of such proceeds;

(*b*) The principles to govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India;

(*c*) The measures needed to augment the State Consolidated Fund to supplement the resources of the panchayats in the State on the basis of the recommendations made by the State Finance Commission;

(*d*) The measures needed to augment the State Consolidated Fund to supplement the resources of the municipalities in the State on the basis of the recommendations made by the State Finance Commission;

(*e*) Any other matter referred to it by the President in the interest of sound finance.

According to Art. 280(4), the Commission is to determine its procedure and is to have such powers as Parliament may by law confer on it. According to the Finance Commission Act, it has all the powers of a civil court for summoning the witnesses, requiring production of any document, requiring any person to furnish information on any point which the Commission regards as useful or relevant to any matter under its consideration. The Finance Commission can be characterised as the balance wheel of the Indian federal financial relationship between the Centre and the States.

The idea of the Finance Commission has been adopted from the model of the Commonwealth Grants Commission of Australia, but there are many interesting points of departure between the two bodies. The Indian Commission is a constitutional body and is not a continuing body, but sits only once in five years. The Australian Commission, on the other hand, is a statutory body, is a continuing body and recommends grants to the deficit States every year. While in Australia, members are appointed for three years at a stretch, in India they are appointed for nearly a year, and the Commission becomes *functus officio* after completing its assigned work. No continuity is provided for in India in the Commission's work.

Further, the Indian Commission has much wider functions to discharge than its Australian counterpart. The latter recommends annual grants to the claimant States, and has nothing to do with the sharing of income-tax which is negotiated between the Centre and the States from time to time. On the other hand, the Indian Commission makes recommendations not only for tax-sharing, but also for 'fiscal-need' grants.

As regards tax-sharing, the scope of the Commission's work has been increasing over time as will be seen below. The Commission not only considers the bases of sharing the taxes which must be shared, or which accrue fully to the States, but also recommends what other taxes the Centre may share with the States. As regards 'fiscal need' grants, it is for the Commission to decide which States need such grants and in what amounts. Besides, other questions of inter-governmental financial relationship are also referred to the Commission for advice from time to time.

The Indian Commission thus plays a significant and pivotal role in adjusting inter-governmental financial relationship. As finance is the *sine qua non* of good government, it will not be an exaggeration to say that the constitution-makers envisaged the Commission as the balance-wheel of the Indian Federalism. By endeavouring to create an equilibrium between the resources and demands at each governmental level, the Commission is designed to ensure that the Indian federal structure continues to function without avoidable stresses and strains. The framers of the Constitution envisaged an expert body functioning on a non-political basis and, thus, the task of devolution of resources from the Centre to the States has been removed from the arena of political bargaining.

The Commission during the course of its work holds discussion, receives memoranda and hears evidence not only from the Central Government and the various State Governments, but even from private individuals and bodies who might be interested in placing their views before it on the questions under its review. It visits all State capitals to hold discussions with the representatives of the State Governments before finalising its report.

Thirteen Finance Commissions have been appointed so far since the commencement of the Constitution, and a review of their work throws a flood of light not only on the evolution of the Central-State financial relations during the last sixty years, but also on the changing panorama of the Indian Federalism.[26] One significant fact is that with each Commission, progressively the amount of Central funds transferred to the States has been increasing.

The Finance Commission envisaged by the Indian Constitution is a unique body. It is an expert body of a non-political character. Thus, the question of devolution of resources from the Centre to the States has been taken out of the arena of political bargaining and entrusted to an objective body and the matter is to be settled on merits and not on the basis of political horse-trading. The Commission, in theory, is an advisory body and its recommendations are not binding on the Central Government.

The Constitution accords to Parliament the supreme authority to oversee the implementation of the Commission's recommendations. This has been ensured by Art. 281 which requires the Central Government to place before both Houses of Parliament recommendations made by the Finance Commission alongwith an explanatory memorandum as to the action taken thereon. However, a convention has developed over time under which the Central Government invariably accepts the recommendations of the Commission as regards the funds to be transferred to the States under the various heads.

In the area of tax-sharing between the Centre and the States prior to the year 2000, the position was as follows:

(a) INCOME TAX

This was a compulsorily shareable tax between the Centre and the States [Art. 270]. The role of the Finance Commission in this area was twofold: *viz.*, first, to determine the proportion of the net income-tax revenue which the Centre should give to the States, and, secondly, to fix the ratios in which the States should share in the divisible pool.

The States' share in the income-tax revenue was gradually increased from 50 per cent, on the eve of the commencement of the Constitution to 85 per cent by the Seventh Finance Commission. The Eighth and the Ninth Commission let it

26. For a detailed review see M.P. Jain, Central-State Fiscal Relationship, footnote 1 on 823.

remain at 85%, but the Tenth Commission reduced it to 77.5% as it thought that the centre ought to retain adequate interest in Income-tax.[27]

The most significant task of the Finance Commission in this area, however, was to evolve the basis on which the States should *inter se* share in the divisible pool. A peculiar circumstance in India is that nearly three-fourths of the income-tax revenue is collected in the two States of Maharashtra and West Bengal, which together have only one-fifth of the country's population. Even in these States, nearly three-fourths of the collection is made within the two cities of Bombay and Calcutta, the two big financial and industrial Centres of India. To these States, the basis of 'collection' suits most for sharing in the divisible pool. On the other hand, the other States, which are less industrialised but more populous, put forward 'population' as the sole basis for the purpose.

The Finance Commissions refused to accept 'collection' as the sole basis of distribution of the income-tax revenue among the States and gave a much larger weightage (90 per cent) to 'population'. The reasons for this approach are that the income arising in an industrialised State is not wholly created there; the underdeveloped regions of the country also contribute to the same by offering vast markets for the sale of industrial production and also by supplying raw materials.

A federal economy is regionally interdependent; no region is self-sufficient by itself and the bases of income are far more diversified and widely spread over the whole country than the figures of income-tax collection would appear to suggest. Industrialisation of a region is promoted not solely by the genius or enterprise of its residents, but also, in a substantial manner, by national policies, geographical factors, etc. Therefore, national considerations should influence the sharing of the proceeds of such enterprises.

A federation being a compromise between economic integration and political autonomy, the existing regional economic inequalities would be further accentuated if proper correctives are not applied and, therefore, emphasis should be placed on 'equalization' rather than on 'collection'. It is almost impossible to establish precisely the contribution made by different regions to a common tax pool in an industrially and commercially complex national economy. Lastly, distribution based on 'collection' might fail to create a balance between resources and demands of social services at the State level.

A proper scheme of distribution of Central revenue among the States should aim at enabling each State to meet its expanding responsibilities concerning people's welfare. Thus, by giving weightage to 'population' and allowing 'collection' only a small (10 per cent) role to play in the formula for distributing income-tax revenue among the States, the Finance Commissions adopted an avowedly egalitarian approach and sought to remedy the regional imbalances by giving larger amounts to populous but economically backward States as compared to the economically advanced States. The latter can mobilise larger resources through the use of other levies (*e.g.,* sales tax, entertainment and motor vehicles taxes, electricity duties, etc.) than the former, and so there is not much justification for giving larger share of income-tax revenue to them.[28]

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27. REPORT OF THE TENTH FINANCE COMMISSION, 22 (1994).

28. Before 2000, the corporation tax was non-shareable. The States had been urging the Finance Commissions to make this tax shareable. The Seventh Finance Commission expressed its inability to do so in view of the existing constitutional provisions. See, REPORT, 65-66.

The Tenth Commission dropped 'collection' as an element in the formula for distribution of income tax revenue among the States. The formula now comprised *inter alia* of two elements, *viz.*, population and the distance of per capita income of a State from the highest per capita income: Other elements used were: area, infrastructure and tax effort made by a State.[29]

The three main considerations in the selection of criteria for determining *inter se* shares of states of the Eleventh Finance Commission were (1) resource deficiency, (2) higher cost of providing services, and (3) fiscal discipline. The Twelfth Commission basis for revenue sharing were population, income distance, area, tax effort and fiscal discipline.

(b) UNION DUTIES OF EXCISES

Central excises were not compulsorily shareable between the Centre and the States. These duties could be shared if Parliament so provided by law [Art. 272]. Nevertheless, to bolster up State finances, the Finance Commissions had recommended sharing of this tax as well.

To begin with, the First Finance Commission recommended 40% revenue accruing from three commodities, *viz.,* tobacco, matches and vegetable products to be given to the States. Since then, the State share in Union excise duties has been progressively increased by the successive Finance Commissions. The Tenth Finance Commission recommended that the share of the States in the net proceeds of the Union excise duties be fixed at 47.5%.[30] Again, in order to strengthen the resources of the poor States, the formula to divide the distributable portion of the excise revenue is devised keeping in view the same factors as in case of distribution of income-tax among the States.

Sharing of Central excise duties with the States augmented their financial resources as these duties constitute an expanding source of revenue because of rapid industrialisation of India.

(c) ADDITIONAL EXCISE DUTIES

To co-ordinate the incidence of Centrally levied excise duties and the State-levied sales taxes, and for convenience of tax collection, a scheme has been put into force, with the consent of the States, under which the States have surrendered sales taxes on four commodities, *viz.*, factory-made textiles, sugar, tobacco and silk fabrics, and the Centre has started levying an 'additional' excise duty on these commodities over and above its normal levy. The entire revenue accruing from the 'additional' levy was distributed among the States as compensation for their losing the sales tax revenue on these commodities. The formula to distribute this revenue among the States was designed so as to enable each State to get the equivalent of what it would have secured had it not surrendered its power to levy sales tax on these commodities.

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29. REPORT, 24.

The Eighth Finance Commission which presented its report in 1984 maintained the share of the States at 85% in the net proceeds of the income tax. The Commission emphasized upon the relative economic backwardness of the States in the scheme of allocation of tax resources among them. The weightage given to the population was reduced. The basis of State contribution was maintained at the same level as before *i.e.,* at 10%.

30. REPORT, 22.

The Ninth Finance Commission adopted the basis of consumption of the concerned articles in the different States for dividing this revenue among them. This Commission maintained the view that since the additional excise duties were levied in lieu of sales tax which itself is a tax on consumption. The Tenth Commission evolved a formula for the purpose based on three elements, *viz.*, population, State domestic product, and collection of State sales tax.[31]

The replacement of sales tax with the additional excise duty has many advantages. It results in a uniform rate of tax throughout the country instead of variable rates of sales tax from State to State and this helps in the free flow of commodities in the country; with the levy of the tax at the stage of production, chances of evasion of the revenue are minimised; traders are spared from much inconvenience involved in rendering accounts for sales tax assessment from State to State.

Because of its advantages, the traders plead that the scheme be expanded further so as to cover more commodities of mass consumption. The traders regard the working of sales tax laws as vexatious and believe that amalgamation will be beneficial to trade and commerce as well as to the States because administrative expenses will be much less and there will be little scope for evasion. The States are not, however, enthusiastic about this. In the sales tax, the States have an expansive and flexible source of revenue and they can adjust the rates of taxation from time to time to suit their budgetary needs. By forgoing this right to levy sales tax, they would compromise their own freedom and autonomy and come to depend for funds on the Centre.[32]

(d) OTHER TAXES

The Finance Commission would also go into the question of distributing among the States of estate duty, grant *in lieu* of tax on railway passenger fares and wealth tax on agricultural property.

The whole of the revenue accruing from estate duty used to go to the States, but this tax has now been abolished.

The revenue accruing from tax on railway fares would also go to the States.[33] The Centre levied such a tax in 1957 but repealed it in 1961 and merged it with railway fares and started giving a fixed grant to the States *in lieu* of the tax on the recommendation of the Finance Commission.

The wealth tax on agricultural property was a residuary tax levied by the Centre since 1970.[34] Although under the Constitution it was not a shareable tax, the Centre *suo motu* decided that the net proceeds accruing from this tax would be passed on to the States as grants-in-aid. The Commission used to lay down the bases on which the States would share this revenue. This tax has now been abolished.

To begin with, revenue realized by way of service tax under Entry 97 of List I was shareable with the states. The position changed after the Constitution (Eighty-eighth Amendment) Act, 2003 which has inserted Article 268-A and Entry 92-C. Revenues from taxation of services that are taxed by the centre under

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31. REPORT, 28 (1994).
32. FICCI, SALES TAX—A PLEA FOR SIMPLIFICATION (1969).
33. *Supra*.
34. *Supra*, sec. G.

Article 268A rather than under Article 270 were excluded from the purview of the finance commission. The Twelfth Commission however recommended that "any legislation that enacted in respect of service tax must ensure that the revenue accruing to a state under the legislation should not be less than the share that would accrue to it, had the entire service tax proceeds been part of the shareable pool".

(e) FISCAL NEED GRANTS

Under Art. 275, the Centre is to give grants to the States in need of assistance.[35] This provision lays down no criteria for judging whether a State is in need of assistance, and if so, to what extent. These matters are left to the Finance Commission for consideration and recommendation. Under Art 280(3)(b), the Finance Commission is to recommend the principles to govern the grants-in-aid of the revenue of the States. Over the years, the revenue flowing to the States under this head has been increasing.

The idea of fiscal need has been borrowed from Australia. As early as 1936, the Commonwealth Grants Commission[36] expounded the idea thus: "Special grants are justified when a State through financial stress from any cause is unable efficiently to discharge its functions as a member of the federation and should be determined by the amount of help found necessary to make it possible for that State by reasonable effort to function at a standard not appreciably below that of the other States". Every year, therefore, the Commission seeks to assess the sums necessary to bring the claimant States to the level of that of the non-claimant States, necessary adjustments being made for the relative tax effort of the States and differences in standards of social services so that these may be brought to a corresponding level. In this process of adjustment, be it noted, the element of self-help is an important constituent, the basic idea of which is that within its taxable capacity a claimant State makes the same relative tax effort as a non-claimant State.[37]

The First Finance Commission in India adopting a somewhat similar approach laid down a few guiding norms for assessing these grants, for example, budgetary needs and the extent of tax-effort made by a State. Failure of a State to maximise tax effort should be taken note of so that no premium is placed on lack of self-help, and no penalty is levied on those States which seek to raise adequate resources. To discourge extravagance, the States' endeavour to secure reasonable economies in expenditure should be taken into consideration. Grants should help in equalising standards of basic social services and, therefore, a State having a significantly lower standard of social services than others should qualify for assistance. Two other matters mentioned by the Commission for the purpose are: State susceptibility to famine, floods, etc; burdens of national concern though falling within the State sphere yet beyond its control. These principles have been applied by the various Finance Commissions with some change of emphasis here and there to assess the fiscal need grants.[38]

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35. *Supra*.
36. *Supra*, p. 928.
37. COMM. GRANTS COMM., THIRD REP., 1-25 (1936); THIRTY-SECOND REPORT, 1-15, (1965).
38. REPORT OF THE FIRST FINANCE COMMISSION, 90-104 (1952).

The underlying idea of these grants is to transfer resources from the rich to the poor States. This concept has now come to be accepted in all federations. However, the methodology adopted by the Commissions in India to compute these grants does not take the process very far. The Commissions have gone too much by the budgetary deficits in assessing grants for the States. The Tenth Commission also recommended grants to several States to cover their budgetary deficits.

This approach has a weakness, *viz.*, a State which shows large deficit by increasing its expenditure and keeping its taxation low, gets larger fiscal need grants from the Centre as compared with the State which keeps its expenditure low or its taxation high. Another notable lacuna in this connection is that there prevails a lack of uniformity in the levels of social services in the several States. For example, in the field of education, the per capita expenditure varies from State to State.

Commenting on the system of fiscal need grants in India in 1970, this author had remarked: "Such an approach on the part of the Finance Commission would further accentuate regional imbalances and create tensions and stresses in the body politic. It is, therefore, necessary for the Finance Commission to evolve some standard of comparison of social services among the States *inter se*, as is done by the Australian Commission, and then apply the necessary correctives so as to bring the services in all the States on a comparable level".[39]

The Sixth Finance Commission explicitly accepted the proposition that the social services in backward States should be improved and assessed funds with a view to progressive equalization of social services within a definite time-period.[40]

Another lacuna in the method of assessment of these grants is that not enough importance has been accorded so far to tax-effort made by the States. In Australia, the aspect has been given a good deal of significance; a State making more than its due effort is rewarded, and the State making less than its due is penalised while assessing the grants. In India, the States do not make adequate tax-effort according to the capacity of the people to pay, and continuously pressurize the Centre for larger allocations.

For a robust federal system, it is necessary that the States do not merely look towards the Centre for money but also indulge in self-help which is essential for them to maintain their autonomy. The Finance Commission should, therefore, give due weight to relative tax severity among the States while assessing fiscal-need grants. Thus, a two-fold process of adjustment appears to be necessary in assessing these grants: (1) bringing State expenditure on social services on a comparable level; (2) taking into account the relative State tax effort. The Seventh Finance Commission also accepted the validity of these principles.

(f) OTHER GRANTS

The drawback pointed out above in the computation of fiscal need grants is being taken care of to some extent by the Finance Commission recommending grants for several purposes, *viz.*, modernisation of administration; upgrading the

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39. *Indian Cons. Law*, 376 (1970).

Also see, M.P. JAIN, Anomalies in the Scheme of Fiscal-Need Grants in India, in THE UNION AND THE STATES, 265-280.

40. REPORT OF THE SIXTH FINANCE COMM., 8, 9, 51, 68 (1973).

standards in non-developmental sectors and services, Education, grants for local bodies.

From the Sixth Finance Commission onwards, upgradation of State administration emerged as a matter of concern for which grants began to be given to the States. The effort being made is to upgrade the administration in 'backward' States to the level of the more advanced States. The items considered for the purpose are police, fire services, jails, record rooms, treasuries and accounts at the district level.

In the field of education, items considered for grant are : promotion of girls' education; facilities for primary schools, providing drinking water in primary schools.

Panchayats/municipalities have recently been formally made an integral part of our federal democratic structure. These institutions are sought to be strenghened by the 73rd and 74th Amendments of the Constitution.[41] Their action or inaction will directly impinge on the welfare of the people.

These bodies will be ineffective if they lack adequate financial resources to discharge their duties.

Under Art. 280(3)(bb), the Commission has been charged with the specific duty of recommending "the measures needed to augment the Consolidated Fund of a state to supplement the resources of *panchayats/*municipalities in the State. The implication of the provisions is that the Centre would help the States financially so that they may transfer adequate resources to the panchayats / municipalities. Accordingly, the Tenth Commission has recommended Central grants to the States for the purpose of augmenting the resources of the panchayats/municipalities.[42] It would have been much more effective if a way could be found to give Central grants directly to the panchayats/local bodies instead of through the medium of the States. There is no assurance that whatever money the Centre gives to the States for helping the panchayats/local bodies will be passed on by the States to these bodies.

The Tenth Finance Commission also recommended specific grants to several States for enabling them to meet their special problems.

(g) CALAMITY RELIEF FUND

On the recommendation of the Ninth Finance Commission, a Calamity Relief Fund (CRF) has been established in each State to which the Centre contributes 75% of the amount. The amount of this Fund for each State is settled by the Finance Commission. This scheme has been continued by the Tenth Finance Commission.

In addition, the Tenth Commission suggested setting up the National Fund for Calamity Relief (NFCR) to deal with a calamity of rare severity. From time to time, calamities of such a severity may occur in one State or other which the concerned State may not be able to cope with its own CRF. In such a situation, the Centre must be in a position to come to the rescue of the troubled State and organise relief therein on a national scale.

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41. *Supra*, Ch. IX.
42. REPORT, 46-48.

To The NFCR, both the States and the Centre subscribe. The size of the fund and the amount of Centre and State contributions thereto (in the ratio of 75: 25) have been settled by the Finance Commission. This fund puts on a formal basis the urge for national solidarity in a moment of distress.

The Twelfth Finance Commission made an innovative departure from the approach of the earlier Commissions by providing for Rs 1,000 crore for maintenance of forests and Rs 625 crore for heritage conservation.[43]

(h) COMMENTS

From the above discussion, it is clear that over the years, the trend has been towards augmenting the flow of funds from the Centre to the States both by way of tax-sharing as well as through fiscal need grants. Each Finance Commission has helped and strengthened this trend. The underlying reason for this has been the inadequate resources but expanding responsibilities of the States.

Over the years, the Finance Commissions have strengthened the resources of the poor States much more than those of the rich States. Thus, an effort is made to reduce regional disparities to some extent. This approach concretises the new concept of co-operative federalism that the federal country is one and indivisible economic unit and that every citizen should be able to get a national minimum of social services irrespective of the fact whether he resides in a poor or a rich State.[44]

It is also worth-while to note that the Central Government has at times used the mechanism of the Finance Commission for a broad consideration of the Centre-State financial relations, and has many a time referred to it, under Art. 280(3), such questions as it could have settled by itself. For example, the Tenth Finance Commission was required to assess the debt position of the States. The Finance Commission plays an important role as resource sharing between the Centre and the States is a critical element in the federal system. In this way, the Centre-State relations are sought to be adjusted on a non-political basis.

The tendency is to treat the Commission as a mechanism of arbitration to decide on the conflicting claims and contentions of the States as well as of the Centre. Although the recommendations of the Commission are not binding on the Centre, and the Constitution merely assigns to it an advisory role, yet the convention has grown under which the Centre invariably accepts Commission's recommendations regarding tax-sharing and grants. There is a practical reason for such an approach. It is realised that if once any change is made in the quantum of grant or share in the Central tax recommended by the Commission for one State, then there would be no end to pressurization by other States for modifications in their favour. On the whole, it can be said that the mechanism of the Finance Commission is fulfilling a significant role in evolving a viable system of Centre-State relationship in India.

M. SPECIFIC PURPOSE GRANTS

Along with tax-sharing and fiscal need grants,[45] Central assistance also flows to the States through grants under Art. 282, which provides that the Union or a

43. See in this connection *T.N. Godavarman Thirumulpad (87) v. Union of India*, (2006) 1 SCC 1, at page 40 : AIR 2005 SC 4256.
44. Co-operative Federalism, see, *infra*, Ch. XIV.
45. *Supra*, Sec. K(ii).

State may make grants for any public purpose notwithstanding that the purpose is not one with respect to which Parliament or the State Legislature, as the case may be, may make laws.

This provision vests in the Centre a very broad power to give grants to the States for any specific public purpose. What is "public purpose"? The attitude of the courts is not to interfere in this matter and leave it to the judgment of the Central Government. The proper place to criticise any grant by the government is the legislature and not the courts.[46]

The grants given under Art. 282 are also known as discretionary grants, the reason being that the Centre is under no obligation to give these grants to any State; the Centre may give such a grant to one State and not to another, and the matter lies solely within the Centre's discretion. The use of the word 'may' in Art. 282 signifies the discretionary nature of these grants. Unlike the 'fiscal need' grants under Art. 275, these grants lie outside the purview of the Finance Commission.

While the funds flowing to the States through the Finance Commission are unconditional, and may even be regarded as coming to the States as a matter of right, the grants under Art. 282 may be conditional and tied to specific purposes.

The technique for grants under Art. 282 is used for a number of purposes. There are programmes which fall within the State sphere for purposes of legislation and administration, but being of an all-India significance, the Centre is also interested in their implementation. Therefore, to promote State action in such areas, the Centre may give grants as incentive to the States. In this way, the financial resources of the Centre, and the legislative and administrative resources of the States are pooled together with a view to achieve certain preferred national goals.

Though the Centre has limited legislative powers, it is not so circumscribed in the matter of giving grants and no question can arise regarding the legality of a Central grant to a State on the ground that the purpose for which the grant is being given lies outside the Central sphere. The grants under Art. 282 are also used to help a State tide over an unforeseen crisis such as famine, drought, floods, etc. Though the fiscal need grants recommended by the Finance Commission make provision for expenditure on such calamities, yet in times of acute distress, the Centre may have to give additional funds to a State to tide over the crisis. Many programmes fall within the Concurrent or the Union List and can thus be implemented by the Centre itself. But keeping in view administrative convenience, these may be left to the States for execution, and the Centre makes grants to the States for meeting the expenditure on these programmes. These schemes continue to proliferate every day as the Centre becomes interested in pursuing many varied social programmes of national importance.

Under Art. 257, the Centre can direct the States to construct and maintain roads of national or military importance, and make grants to the States under Art. 282 to meet expenditure on programmes undertaken by them under the Central directive.[47] The grants under Art. 282 are thus given to meet multifarious situa-

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46. *K.N. Subba Reddy v. State of Karnataka,* AIR 1993 Kant 66; *Brij Kishore Mohanty v. State of Orissa,* AIR 1975 Ori. 8.

47. For Art. 257, Sec. E, see, Ch. XII,*infra.*

tions and, accordingly, in terms of money and variety of programmes, such grants play a very significant role in the present-day pattern of Centre-State fiscal relationship. These grants have enabled the States to launch or expand activities in various fields.

The most significant use of these grants is being made in the area of planning.[48] Because of the exigencies of the Five Year Plans, the plan grants under Art. 282 have assumed a dominant position in the scheme of Centre-State fiscal relations. Grants under Art. 282 have increased manifold under the impact of planning and have dwarfed the fiscal need grants being given through the Finance Commission. 'Economic and social planning' is a Concurrent subject.[49] Many plan programmes fall within the State sphere for which the Centre has no direct constitutional responsibility but, as the State resources are inadequate, the Centre makes grants to the States under Art. 282.

These grants have a twofold purpose: to help the States financially to fulfil plan targets and to give some leverage to the Centre to influence and co-ordinate State action to effectuate the national plan. The Centre can use the grants to persuade, encourage and pressurize the States to keep within the plan targets. Because of the gigantic nature of the plan grants, Art. 282 has assumed a unique importance in the present-day Indian Federalism. Art. 282 grants are much larger in dimension than the fiscal need grants made to the States through the Finance Commission, and, therefore, Art. 282 has emerged as the most significant constitutional provision for transfer of funds from the Centre to the States. And since most of the Art. 282 funds are given on the advice of the Planning Commission,[50] in effect, it has assumed a very significant role in the area of Centre-State financial relationship as compared to the Finance Commission.

The State Planning sector consists of the Central-aided schemes and non-aided schemes. The Central sector comprises of Central schemes, and the Central-sponsored schemes which fall for administration within the State sphere, but are counted not in the State but the Central sector, and for which the Centre gives aid to the States. In effect, therefore, the State sector consists of not only the State sector as such but also the Central-sponsored schemes.

Allocation of Central money to the States under Art. 282 has raised a few controversies. The States constantly pressurize the Centre for larger funds and accuse it of partisanship, favouritism or prejudice in favour of, or against, some States. To allay such an apprehension, it is necessary that the basis of allocation of Central funds among the States is clearly laid down so that the indices and criteria adopted for the purpose are well known. Usually, Art. 282 grants are given on a matching basis, *i.e.*, States themselves have to find a part of the money to earn the Central funds for a particular programme. This raises the question whether there should be a uniform matching basis for all States, or that it should favour the poor States. A uniform matching basis may be inequitable as it may favour the rich States as against the poor States, for the former are in a better position than the latter to find the countervailing funds and avail of the Central grants.

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48. See, *infra*, Ch. XIV, Sec. G.; Entry 20, List III, Ch. X, Sec. F.
49. *Supra*, Ch. X, Sec. F.
50. *Infra*, Ch. XIV, Sec. G, under Co-operative Federalism.

In the U.S.A., where a very elaborate system of conditional grants is in operation, it has come to be accepted that such grants should serve an equalitarian purpose and, therefore, the same should happen in India as well. Further, in the U.S.A., the Centre exercises supervision in order to ensure that the States utilise the money for the purposes for which it is given.

No effective supervisory apparatus has been created in India so far and the States enjoy freedom to utilise Central funds to some extent. On the whole, the States do not very much like the system of conditional grants for several reasons. First, being tied to specific purposes, the States are not free to use the money for any other purpose. Secondly, because of the matching requirement, the States must find their share before they can utilise the Central money and they find this restriction irksome. The evolution of a proper system of Art. 282 grants is very much tied up with plan methodology, but the above objections do not have much substance. The justification underlying the matching condition is that it is primarily a State activity which the Centre seeks to finance and it should, therefore, ensure that the State concerned itself takes an abiding interest in the programme. The matching requirement spurs the States into activity and makes them find money for their share through taxation, economy or re-appropriations.

It is also necessary to make the grants programme-oriented, otherwise the targets which the Centre wants to achieve may never be fulfilled. In India, large amounts of unconditional revenue are given to the States by the Centre through the Finance Commission, and the States should not have a cause for grievance if matching grants are also instituted, especially when the activities thus sought to be promoted fall within their constitutional sphere and not that of the Centre. It also should be noted that the burden of matching funds by the States will sooner or later be passed on to the Centre, for this part of the State expenditure will also be taken into consideration by the Finance Commission for assessing the fiscal-need grants. Therefore, the responsibility of the States to find matching funds exists only till the next Finance Commission considers the question of fiscal-need grants, and this period can in no case be more than five years.

From time to time, efforts have been made to persuade the Centre to give plan grants not under Art. 282, but as fiscal need grants through the Finance Commission. The Central Government has not accepted this idea for several reasons. It will lose whatever leverage it has to ensure that the States keep themselves within the framework of the plan. If money is given to the States without being tied to specific purposes, then the States may spend the same on purposes outside the plan structure and the plan targets may thus go awry.

In the U.S.A., it is only the system of conditional grants on a matching basis that is operative at present. The Centre gives no unconditional revenue. In Canada and Australia, the position is somewhat akin to India as both conditional and unconditional funds are given by the Centre to the units. The conditional grants have done much good in the U.S.A. as they have helped in stimulating the States to launch and expand many welfare activities, and have also greatly improved the State administration. The system has proved useful and it is expanding all the time as more and more activities are brought within its purview. There is no reason why conditional grants should not play a similar role in India.

N. BORROWING POWER

The Central Government can borrow within such limits, if any, as may be fixed by Parliament by law. Under Art. 292, the executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed.

Similarly, under Art. 293(1), the executive power of a State extends to borrowing within India upon the security of its Consolidated Fund within such limits, if any, as may from time to time be fixed by the State Legislature by law and to the giving of guarantees, within such limits, if any, as the State Legislature may fix by law.

No quantitative restriction on loans has yet been fixed either by Parliament or by any State Legislature.

Under Art. 293(2), the Central Government may, subject to the conditions as may be laid down by a law of Parliament, make loans to any State, or give guarantees for loans raised by a State, within the amounts fixed by Parliament, if any. Any sums required for making of such loans are charged on the Consolidated Fund of India.

Under Art. 293(3), a State may not raise any loan without the Centre's consent if there is still outstanding any part of a loan made by the Centre to the State, or in respect of which the Centre has given any guarantee. The Central Government may, however, give its consent to a State to raise a loan subject to such conditions as it may think proper to impose [Art. 293(4)]. As all the States owe money to the Centre, in effect, today no State can raise loan without the Centre's consent. The States are also debarred from raising any loan out of India. Foreign loans can be raised exclusively by the Centre [see, Entry 37, List I].[51]

Since the inauguration of the era of planning, Central loans to the States have been increasing by leaps and bounds. The States now complain that much of their annual taxation is consumed by payments made to the Centre towards loans and interest thereon.

The question of State indebtedness to the Centre has become a complicated matter because of several factors, *viz.*, the number of loans is large; terms of repayment and rates of interest vary from loan to loan; while the bulk of the loans have been given for developmental and productive purposes, some part of the same has also been spent on unproductive purposes.

The Second Finance Commission recommended that "it will simplify matters and save a great deal of labour and accounting if these loans are consolidated and the rates of interest and terms of repayment rationalised".[52] The question of State indebtedness to the Centre has been considered since then by several Finance Commissions.[53]

The Seventh Finance Commission recommended a write off of over Rs. 942 crores of Central loans to the States. The Commission also evolved a new con-

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51. *Supra*, Ch. X, Sec. D.
52. REPORT OF THE SECOND FINANCE COMM., 53 (1957).
53. REPORT OF THE SIXTH FINANCE COMM., Chap. XVII (1973).

cept—'loans in prepetuity'. Over Rs. 3000 crores advanced to the States out of small savings have been converted into such loans. Besides, relief in debt-repayment amounting to over Rs. 2155 crores within a five year period (ending 1983-84) was also recommended by the Commission.

The Tenth Finance Commission has estimated that the total debt of the State Governments would be Rs. 2,09,159 crores as on 31st March, 1995. Loans advanced by the Centre to assist financing of State plans constitute the bulk of the total State debt. The debt liability has placed a huge burden of debt servicing on the States. The Commission has made some proposals for debt relief.[54]

The Commission has drawn attention to three disturbing features of the debt profile of the States, *viz*.:

(1) debt funds are being used for meeting revenue expenditure;

(2) loan funds are being used in unproductive enterprises; and

(3) in respect of government owned assets, no provision is being made for depreciation or amortisation of funds. This leads to repayment of loans out of fresh borrowings.

The Eleventh Finance Commission has observed in connection with the borrowing power of the Centre and the States:[55]

> "A time has come when, as a part of the overall thrust towards fiscal responsibility, concrete steps are taken under the provisions of articles 292 and 293. In particular, Parliament and respective State Legislatures may consider fixing limits on total borrowing as well as on guarantees to be given by them."

The Twelfth Commission recommended that each state must enact a fiscal responsibility legislation prescribing specific annual targets with a view to eliminating the revenue deficit by 2008-09 and reducing fiscal deficits based on the basis of reduction of borrowings and guarantees. Enacting the fiscal responsibility legislation on the lines indicated in its Report would be a pre-condition for availing of debt relief. It was also said that "States, like the centre, must decide their annual borrowing programme, within the framework of their respective fiscal responsibility legislations". Other major steps recommended were the need to let the states access the market directly for their borrowing requirements and the fixing and supervision of the overall limit to states' annual borrowing from all sources by an independent body like a Loan Council. [56]

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54. REPORT OF THE TENTH FINANCE COMM., Ch. XII (1994).
55. REPORT OF THE ELEVENTH FINANCE COMM., 107 (2000).
56. REPORT OF THE TWELFTH FINANCE COMM. (Ch XV) (2004),