THE DISCRETION AVAILABLE TO LAW-MAKERS IN RESPECTS OF MAKING CLASSIFICATION FOR THE PURPOSES OF TAXATION

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ABSTRACT

The Legislature determines the rate of tax and objects be taxed. The courts have a tolerant attitude towards tax legislation. Judicial tolerance towards tax law is not only because it is a source of raising money for the government but also it is a medium to reduce inequalities in the society. Classification is made when taxes are levied on or exempted from a particular commodity. Such classification cannot result from a blind approach adopted by the Legislature; there needs to be reasonableness and a rationale behind such law. This article aims to analyse the extent of discretion available to lawmakers in India and explore the degree of tolerance the courts have in matters of taxation.

Keywords: Tax Laws, Inequalities, Reasonableness, Art. 14

INTRODUCTION

Art. 14 covers tax legislation as well. Tax laws do not fall outside the scope of Art. 14, and such laws must also pass the test of Art. 14. There is less judicial indulgence in taxation as one would expect because choosing within limits is inevitable in taxation. The principle of classification is applied rather liberally in the case of a taxing statute. The Legislature enjoys a great deal of latitude in the classification of objects and purposes of taxation. The courts have a tolerant attitude towards a tax legislation. The courts assert that because of the intrinsic complexity of fiscal adjustments of diverse elements, a legislature ought to be permitted a more extensive discretion and latitude in classification for taxing purposes.[1]

LEGISLATURE'S WIDE LATITUDE IN MATTERS TO BE TAXED

The Legislature determines the rate of tax and objects be taxed. The Court only interferes when Legislature drafts the law to be something unreasonable.[2] On this point, the Supreme Court has observed in *Khandige*:[3]

> "*.... The courts, in view of the inherent complexity of fiscal adjustment of diverse elements, permit a larger discretion to the Legislature in the matter of classification, so long it adheres to the fundamental principles underlying the said doctrine. The power of the Legislature to classify is of "wide range and flexibility" so that it can adjust its system of taxation in all proper and reasonable ways.*"

Again, the Court has observed in *Hoechst*:[4]

> "*When the power to tax exists, the extent of the burden is a matter for discretion of the law-makers. It is not the function of the Court to consider the propriety or justness of the tax, or enter upon the realm of legislative policy. If the evident intent and general operation of the tax legislation is to adjust the burden with a fair and reasonable degree of equality, the constitutional requirements is satisfied.*"

[1] State of Maharashtra v. M.B. Badiya, AIR 1988 SC 2062; State of Karnataka v. D.P. Sharma, AIR 1975 SC 594: Anant Mills v. State of Gujarat, AIR 1975 SC 1234: 1.T.O., Shillong v. N.T.R. Rymbai, AIR 1976 SC 670; Ganga Sugar Corp. v. State of Uttar Pradesh, AIR 1980 SC 286; State of Karnataka v. Hansa Corp., AIR 1981 SC 463; Laxmi Narain v. State of Orissa, AIR 1983 Ori. 229; State of Bihar v. S.K. Sinha, AIR 1995 SC 885.

[2] Meenakshi v. State of Karnataka, AIR 1983 SC 1283, 1289.

[3] Khandige Sham Bhai v. Agri. Income Tax Officer, AIR 1963 SC 591. *See also:* Khyerbari Tea Co. v. State of Assam, AIR 1964 SC 925.

[4] Hoechst Pharmaceuticals Ltd. v. State of Bihar, AIR 1983 SC 1019. *See also:* State of Kerala v. Aravind Ramakant Modawadakar. (1999) 7 SCC 400.

Judicial tolerance towards tax law is not only because it is a source of raising money for the government but also to reduce inequalities in the society. Therefore, the Legislature enjoys freedom while applying the doctrine of classification in matters of taxation. As all taxation schemes are discriminatory, a tax measure can only be struck down under Art. 14 for being arbitrary.[5]

Parliament imposed expenditure tax on hotels where room charges were Rs. 400 or over per day for a unit of residential accommodation. Holding the Act valid against a challenge under Art. 14, the Supreme Court emphasised that having regard to the wide variety of diverse economic criteria that go into the formulation of a fiscal policy, the Legislature in India enjoys a broad latitude concerning the selection of persons, subject matter, events, etc. for taxation.[6]

In the field of taxation, the Supreme Court has permitted the Legislature to exercise vast discretion in classifying objects for taxing purposes, so long as it refrains from clear and hostile discrimination against particular persons or classes. A tax on purchasers of hides and skins only, and not on purchasers of other commodities, was held valid as there was no material on the record' to suggest that the purchasers of other items were similarly situated as those of hides and skins.[7]

A sales tax imposed on sales of Virginia tobacco but not of country tobacco is not bad under Art. 14, for the former, has certain features which distinguish it from the latter.[8] A higher show tax on cinema houses with ample seating accommodation situated in fashionable, busy or prosperous localities than on tiny cinema houses containing less accommodation and located in poor localities is valid.[9] Classification for purposes of income-tax concerning the sources of income is valid.[10] Differential rates of tax can be imposed on stage carriages and goods vehicles

[5] Kerala Hotel and Restaurant Association v. State of Kerala, AIR 1990 SC 913; Khadi & Village Soap Industries Association v. State of Haryana, AIR 1994 SC 2479; Spences Hotels Pvt. Ltd. v. State of West Bengal, (1991) 2 SCC 154; Gannon Dunkerley & Co. v. State of Rajasthan. (1993) I SCC 364; L.T.O. v. N. Takim Roy Rymbai, AIR 1976 SC 670; G.K. Krishna v. State of Tamil Nadu, AIR 1975 SC 583; State of Gujarat v. Sri Ambica Mills, AIR 1974 SC 1300; Hiralal v. State of Uttar Pradesh, AIR 1973 SC 1034: Jaipur Hosiery Mills v. State of Rajasthan, AIR 1971 SC 1330.

[6] Elel Hotels and Investments Ltd. v. Union of India, AIR 1990 SC 1664. *See also:* R. C. Tobacco (P) Ltd. v. Union of India, (2005) 7 SCC 725. Wide discretion conferred on legislature in tax and economic matters; *See also* Gujarat Ambuja Cements Ltd. v. Union of India, (2005) 4 SCC 214.

[7] V.M. Syed v. State of Andhra Pradesh, AIR 1954 SC 314.

[8] East India Tobacco Co. v. State of Andhra Pradesh, AIR 1962 SC 1733.

[9] Western India Theatres v. Cantonment Board, AIR 1959 SC 582.

[10] L.T.O., Shillong v. N.T.R. Rymbai. AIR 1976 SC 670.

as the two belong to distinct categories.[11] Levy of a higher grazing rate for animals belonging to the outsiders than on those belonging to the residents of the State is discriminatory as there is no rational basis for making such a distinction.[12]

Parliament enacted a law imposing expenditure tax at 10% ad valorem on 'chargeable expenses' incurred in hotels wherein room charges were Rs. 400 or over per day for a unit of residential accommodation. The Act was challenged under Art. 14. The argument was that there was no basis or intelligible differentia for discriminating between the levy of the tax on expenditure over food or drink provided by a hotel and the food and drink provided by a restaurant or eating house not situated in a hotel even though the cost of food or beverage could be higher than that on similar items in a taxed hotel. The Court held the tax valid, arguing that "*the bases of classification cannot be said to be arbitrary or unintelligible nor as without a rational nexus with the object of the law.*" People with economic superiority would enjoy the services of a hotel having accommodation priced at Rs. 400/- or more per day. This basis of classification could not be condemned as irrational. The Court emphasised that having regard to the wide variety of diverse economic criteria that go into formulating a fiscal policy, Legislature enjoys wide latitude in selecting persons, subject matter, events, etc., for taxation purposes. The tests of the vice of discrimination in a taxing law are, accordingly, less rigorous.[13]

The Tamil Nadu Government levied an entertainment tax on admission to cinema theatres. Different rates were prescribed depending on the locality where the cinema was situated and the amenities provided therein. The tax was levied at a particular percentage of the rate of admission. This percentage varied from locality to locality. The tax was challenged under Art. 14, but the Supreme Court ruled that the classification made between the theatres was not an unreasonable one. The Court emphasised that the concept of "Equality before law" contained in Art. 14 envisages "*obligation upon the State to bring about an equal society envisaged by the Preamble 61 and Part IV through the machinery of the law of our Constitution. For, equality before the law can be predicated meaningfully only in an equal society.*"[14]

[11] Ambala Bus Syndicate (Pvt.) Ltd. v. State of Punjab, AIR 1983 P&H. 213.
[12] Lakshman v. State of Madhya Pradesh, AIR 1983 SC 656.
[13] Federation of Hotel and Restaurant v. Union of India, AIR 1990 SC 1637.
[14] Sri Srinivasa Theatre v. Govt. of Tamil Nadu, AIR 1992 SC 999.

In Andhra Pradesh, for levying a similar tax, the Legislature prescribed different tax rates by classifying theatres into different classes, namely, air-conditioned, air-cooled, ordinary, permanent, semi-permanent, touring and temporary. The theatres were further categorised on the basis of the type of the local area in which they were situated. The levy was held valid as the Legislature had sought to classify the cinema theatres taking into consideration the differentiating circumstances to impose the tax. The Court rejected the argument of the theatre owners that the classification was not perfect and that there should have been further classification amongst the theatres falling in the same class based on the location of the theatre in each local area.[15]

RATIONALE BEHIND THE LAW

To find out discrimination, what is decisive is not the phraseology of a statute but the impact and effect of the law. A law *ex facie* non-discriminatory may in effect operate unevenly on persons or property not similarly situated and thus offend the equality clause. Conversely, a law appearing to be discriminatory may not be so in actual operation.[16] Just as a difference in the treatment of persons similarly situated leads to discrimination, discrimination can also arise if unequal persons, i.e., differently placed, are treated again. Unless there is a rationale behind the law providing discriminatory rules and object to be achieved by such law, it can be struck down.

This proposition is illustrated by *K.T. Moopil Nair v. State of Kerala*.[17] A land tax at a flat rate of Rs. 2 per acre was declared irrational as it did not refer to income, either actual or potential, from the land tax. A flat rate of tax was imposed whether or not there was any income from the property. The Act in question did not have any regard to the quality of the land or its productive capacity, and so the levy of the tax at a flat rate was invalid. Lack of classification by the Act, therefore, created inequality. This was evident from the facts of the instant case, where the petitioner was required to pay a tax of Rs. 54,000/- per year, while the income from the land taxed came to Rs. 3,100/- only. The tax was therefore characterised as discriminatory and confiscatory and hence bad under Art. 14.

[15] Venketeswara Theatre v. State of Andhra Pradesh, AIR 1993 SC 1947.
[16] *Khadinge* Supra note 3.
[17] AIR 1961 SC 552.

Following the *Moopil Nair* case, the Supreme Court in the *State of Andhra Pradesh v. Raja Reddy*[18] declared void land revenue imposed at a flat rate on land without taking into account the quality or productivity of the soil. Moreover, the Act laid down no procedure to assess land revenue, and however, grievous the mistake made in the assessment, there was no way for the aggrieved party to get it corrected. No notice was prescribed, and no opportunity was given to the assesee to question the assessment on his land. The Court emphasised that Art. 14 can be offended both when a statutory provision finds differences where there are none or makes no difference where there is one. Even a tax law cannot introduce unreasonable discrimination between persons or property either by classification or lack of it.

A tax on buildings on the 'floorage' basis (the rate of tax being determined by the floor area) on a sliding scale, whether the building be situated in a large industrial town or in an insignificant village, was held discriminatory under Art. Fourteen as the rate of tax did not depend upon the purpose for which the building was used, the nature of the structure, the town and locality in which the building was situated, the economic rent obtainable from the building, its cost and other related circumstances which might appropriately be taken into consideration in any rational system of taxation of buildings. No attempt was made at any rational classification in imposing the tax in question. Imposing a uniform tax on objects, persons or transactions essentially dissimilar may result in discrimination.[19] A tax on urban land was held invalid because of a lack of classification, which resulted in inequality and hostile discrimination.[20]

Kerala levied a tax at the rate of Rs. 50 per hectare on seven types of plantations. The tax was challenged on the ground of lack of classification. By a majority of 3: 2, the Supreme Court upheld the tax. The majority found that the law wanted to equalise the different plantations for purposes of taxability. *Hidayatullah, C.J.*, speaking for the majority, observed: ".. *the burden of proving discrimination is always heavy and heavier still when a taxing statute is under attack...The burden is on a person complaining of discrimination. The burden is proving not possible 'inequality' but hostile 'unequal' treatment. This is more so when uniform taxes are levied.*"

[18] AIR 1967 SC 1458. *See also:* Samerendra Nath v. State of West Bengal, AIR 1981 Cal. 58.
[19] State of Kerala v. Haji Kutty, AIR 1969 SC 378.
[20] Parshava Properties Ltd. v.State of West Bengal, AIR 1982 Cal 202.

On the other hand, the minority held that tax was discriminatory as it was not related to the productivity of the land. For example, the average yields of the lands varied from 350 kgs to 1850 kgs of tea, and so a uniform tax must result in inequality among tea-growers who formed one class.[21] The minority view seems to be more rational in this case.

REASONABLENESS OF THE CLASSIFICATION

When taxes are levied on or exempted from a particular commodity, classification is to be made. Such classification cannot be a result of a blind approach by the administrative authorities on which the Constitution rests the responsibility of delegated legislations. A notification issued by a Taxing Department of a State which lacks a sense of reasonability and it is not able to establish a rational balance of classification would be ultra vires Art. 14.[22]

The reasonableness of classification must be examined on the basis that when the object of the taxing provision is not to tax the sale of certain chemical fertilisers included in the list, which clearly points out that all the fertilisers with similar compositions must be included without excluding any other chemical fertiliser which has the same elements and, as such, there is no basis for differential treatment amongst the same class. The Court referred to the Ayurveda Pharmacy case,[23] which had held that two vital items of the same category could not be discriminated against and where such a distinction is made between the items falling in the same category, it should be done on a reasonable basis, in order to save such a classification being in contravention of Art. 14 of the Constitution.[24]

Classification on the basis of capacity to pay for purposes of taxation is valid. It is, therefore, permissible to levy a higher tax on those who are economically stronger than those who are weaker. "*The object of a tax is not only to raise revenue but also to regulate the economic life of the society.*"[25]

A flat-rate tax may not be bad always. It is only in marginal cases when the impact of such a tax is glaringly discriminatory or expropriation that it may be hit by Art. 14. Therefore, a tax

[21] Twyford Tea Co. v. State of Kerala, AIR 1970 SC 1133.
[22] State of Uttar Pradesh v. Deepak Fertilizers & Petrochemical Corpn. Ltd. (2007) 10 SCC 342.
[23] (1989) 2 SCC 285.
[24] *Deepak Fertilizers* Supra note 22.
[25] Kodar v. State of Kerala, AIR 1974 SC 2272; *See also: Hoechst* Supra note 4.

of Rs. 1 per bottle of foreign liquor (produced in India) is valid as it is levied at a conveniently flat rate with minimal effect on the overall price, and it is easy to collect.[26]

A classification made to prevent evasion of tax and fraud on taxation may be held valid under Art. 14.[27] The Central Government classified match manufacturing units into mechanised and non-mechanised units and levied a lower excise duty on the latter than on the former. It was argued that the non-mechanised category did not distinguish between stronger and weaker units and thus was treated unequals as equals. Rejecting the contention, the courts held that a pertinent principle of differentiation linked to productive processes had already been adopted, and further sub-classification between strong and weak units in the same class could not be insisted upon with reference to Art. 14.[28]

Several State Legislatures enacted statutory provisions levying cesses/taxes on minerals. These provisions were struck down by the Supreme Court on the ground that the power to impose these levies vested with Parliament and not the States. The State levies were at different rates. To protect the States from refunding the revenue collected from these levies, Parliament enacted an Act validating the State levies with retrospective effect. This Act was challenged inter alia under Art. 14 on the ground that it imposed levies in different States at different rates. The Court held that there was no violation of Art. 14 by Parliament as there was historical justification for the law in question. The different States were imposing levies at different rates and validating the State levies; Parliament had to adopt the very rates prevailing in the various States.

> "*It is really not a case where the Parliamentary enactment is creating the distinction or different treatment. Distinction and different treatment were already there over several decades; each State was prescribing its own rate on the same material... The Parliament has intervened and, by enacting the impugned law in the exercise of its undoubted power, validated the levy and all that flows from it. In such circumstances, there was no other way except to do what has actually been done.*"

[26] Balaji v. I.T.O., AIR 1962 SC 123.
[27] Avinder Singh v. State of Punjab, AIR 1979 SC 321.
[28] M. Match Works v. Asstt. Collector, AIR 1974 SC 497.

When Parliament was re-enacting the very provisions prevalent in the States, it could not but adopt those very rates.[29] Differentiation in taxation levied on intra-state and inter-State contract carriages was upheld by the Supreme Court in the following case,[30] on the ground that "*in many factual ways the vehicles covered by two different permits do form a separate and distinct class.*" The courts would not interfere with classification, "which is the prerogative of the legislature", so long as it was not arbitrary or unreasonable. The nexus of the classification with the object of taxation in the instant case lay in public interest, "*which is again within the realm of legislative wisdom unless tainted by perversity or absurdity.*"

CONCLUSION

Broad latitude is available to the Legislature in the classification of objects, persons and things for the purpose of taxation. There are limits against the Legislature in the classification of objects, persons and things. However, the Supreme Court has reiterated that, "*the State has a wide discretion in selecting the persons or objects it will tax and thus a statute is not open to attack the ground that it taxes some persons or objects and not others.*" Even though there are no express constitutional limits on this power of the legislature, the words "Equality before Law" and "Equal protection of law" set up boundaries. Where an act is arbitrary, it is implicit in it that it is unequal both according to political logic and constitutional law and is therefore violative of Article 14.[31] Equity that arises in favour of a party as a result of a representation made by the State is founded on the basic concept of "justice and fair play".[32] Nevertheless, the burden of proof is always on the citizens to prove that inequality has occurred or the state action is arbitrary which further proves the wide latitude available to the State.

[29] P. Kannadasan v. State of Tamil Nadu, AIR 1996 SC 2560.
[30] *Aravind* Supra note 4.
[31] E.P. Royappa v. State of Tamil Nadu, (1974) 4 SCC 3.
[32] MRF Ltd., Kottayam v. Asst. Commissioner (Assessment) Sales Tax & Ors., (2006) 8 SCC 702.