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Dear Professional Colleague,

Entry tax levy upheld by the Supreme Court

The Hon'ble Supreme Court on November 11, 2016, has upheld that constitutional validity of Entry tax imposed by States. A nine-judge Constitution Bench, overruling 'compensatory tax' theory propounded by 7 judges bench in the case of ***Atiabari Tea Co. Ltd. Vs. State of Assam & Ors. [AIR 1961 SC 232]***, declared that it does not restrict freedom of trade or other constitutional provisions on Inter-State trade.

We are sharing with you a landmark judgement of the Hon'ble Supreme Court of India in the case of ***Jindal Stainless Ltd. & Anr. Vs. State of Haryana & Ors. [TS-455-SC-2016-VAT]***, on the following issues:

Issues:

- Can the levy of a non-discriminatory tax per se constitute infraction of Article 301 of the Constitution of India?
- If answer to question above is in the affirmative, can a tax which is compensatory in nature also fall foul of Article 301 of the Constitution of India?
- What are the tests for determining whether the tax or levy is compensatory in nature?
- Is the Entry tax levied by the States is violative of Article 301 of the Constitution and in particular have the impugned State enactments relating to Entry tax to be tested with reference to both Articles 304(a) and 304(b) of the Constitution for determining their validity?

Facts & Background:

These appeals bring to fore for determination of vexed questions touching the interpretation of Articles 301 to 307 comprising Part XIII of the Constitution of India, which have been the subject matter of several Constitution Bench decisions of the Hon'ble Supreme Court, all but one, decided by majority.

In exercise of their legislative powers under Entry 52 of List II of the Seventh Schedule to the Constitution, several States in the country, at least 14 of whom are parties to these proceedings, have enacted laws that provide for levy of a tax on the "entry of goods into local areas comprising the States". The constitutional validity of these levies was questioned in the different High Courts by assesses/dealers aggrieved of the same, inter alia, on the ground that the same were violative of the constitutionally recognised right to free trade commerce and intercourse guaranteed under Article 301 of the Constitution of India. Article 301 of the Constitution of India is reproduced hereunder for ease of reference:

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“301. Freedom of trade, commerce and intercourse:

Subject to the other provisions of this Part, trade, commerce and intercourse throughout the territory of India shall be free.”

The levies were also assailed on the ground that the same were discriminatory and, therefore, violative of Article 304(a) of the Constitution of India. Absence of Presidential sanction in terms of Article 304(b) of the Constitution of India was also set-up as a ground of challenge to the levies imposed by the respective State legislatures. Article 304 of the Constitution of India is reproduced hereunder for ease of reference:

“304. Restrictions on trade, commerce and intercourse among States:

Notwithstanding anything in article 301 or article 303, the Legislature of a State may by law-

(a) impose on goods imported from other States or the Union territories any tax to which similar goods manufactured or produced in that State are subject, so, however, as not to discriminate between goods so imported and goods so manufactured or produced; and

(b) impose such reasonable restrictions on the freedom of trade, commerce or intercourse with or within that State as may be required in the public interests:

Provided that no Bill or amendment for the purposes of clause (b) shall be introduced or moved in the Legislature of a State without the previous sanction of the President.”

Writ Petition (Civil) No. 8700 of 2000 filed before the High Court of Punjab and Haryana was one such petition that assailed the constitutional validity of the Haryana Local Development Act, 2000. Relying upon the decisions of the Hon’ble Supreme Court in the case of ***Atiabari Tea Co. Ltd. Vs. State of Assam & Ors. [AIR 1961 SC 232]*** (“Atiabari case”), ***Automobile Transport (Rajasthan) Ltd. etc. Vs. State of Rajasthan & Ors. [AIR 1962 SC 1406]*** (“Automobile Transport case”), ***M/s. Bhagatram Rajeev Kumar Vs. Commissioner of Sales Tax, M.P. and Ors. [(1995 Supp [1] SCC 673)]*** (“Bhagatram case”) and ***State of Bihar and Ors. Vs. Bihar Chamber of Commerce and Ors [(1996) 9 SCC 136]*** (“Bihar Chamber case”), a Division Bench of the Hon’ble High Court of Punjab and Haryana dismissed the said petition and connected matters on the ground that the levy was compensatory in character hence outside the purview of Article 301 of the Constitution.

The correctness of the said order was assailed before the Court in ***Jindal Stripe Ltd. and Anr. Vs. State of Haryana and Ors. [(2003) 8 SCC 60]*** (“Jindal Stripe case”). A two-Judge Bench of the Court, however, referred the matter to a larger Bench as it noticed an apparent conflict

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between the pronouncements of the Court in *Atiabari* and *Automobile Transport* cases on the one hand and *Bhagatram* and *Bihar Chamber* cases on the other.

The matters were, pursuant to the above, placed before a Constitution Bench of the Court in the case of ***Jindal Stainless Ltd. and Anr. Vs. State of Haryana and Ors. [(2006) 7 SCC 241]*** ("**Jindal Stainless case**"), which resolved the conflict noticed in the reference order by holding that the working test propounded by seven Judges in *Automobile Transport* case was incompatible with the test of 'some connection' enunciated by the three Judge Bench in *Bhagatram* case. The Court held that the test of 'some connection' as propounded in *Bhagatram* case had no application to the concept of compensatory tax. The Court, accordingly, overruled the decisions rendered in *Bhagatram* and *Bihar Chamber* cases and held that the doctrine of 'direct and immediate effect' of the impugned law on trade and commerce under Article 301 as propounded in *Atiabari* case and the working test enunciated in *Automobile Transport* case for deciding whether a tax is compensatory or not will continue to apply.

The matters were, in terms of the above direction, listed before a two-Judge bench for hearing of the appeals in the light of the above pronouncement of the Constitution Bench. The two-Judge Bench, however, noticed that although the basic issue in the appeals revolved around the concept of compensatory tax, the High Courts had not examined the same as they had considered themselves bound by the view taken in *Bhagatram* and *Bihar Chamber* cases. The Court further found that in the absence of relevant data before the High Courts, the issue whether the levies were compensatory could not have been considered and accordingly referred the matter back to the High Courts to decide the said aspect. The appeals were, in the meantime, adjourned to await the finding from the High Courts on the question whether the levies were indeed compensatory in nature having regard to the decisions of this Court in *Atiabari* and *Automobile Transport* cases.

The matters were accordingly taken up by the High Courts, after the remand, who came to the conclusion that the impugned levies were neither compensatory in character nor was the procedure stipulated by Article 304(b) and the proviso to the same followed. The levies were on that basis held to be in violation of Article 301 being an impediment to free trade, commerce and intercourse and accordingly struck down. The High Courts of Assam, Arunachal Pradesh, Jharkhand, Kerala and Tamil Nadu also struck down the levies imposed by their respective States also on the ground that they were discriminatory in nature hence violative of Article 304(a) of the Constitution.

All these judgments and orders of the High Courts, passed after the remand, then, challenged by the States concerned in the appeals filed against the same. These appeals initially came-up before a two-Judge Bench of the Court comprising Justice Arijit Pasayat and Justice S.H. Kapadia. Their Lordships referred the same to a Constitution Bench for an

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authoritative pronouncement on as many as ten questions formulated in the reference order (***Jaiprakash Associates Limited Vs. State of Madhya Pradesh and Ors. [(2009) 7 SCC 339]***). The Court noticed the arguments advanced on behalf of the assesseees that Entry taxes were, in essence and in the classical sense, in the nature of 'a fee' and not 'a tax'. It also noted the contention that all the cases on which the parties had placed reliance related to Entry tax in the context of tax on vehicles in contradiction to taxes on entry of goods. The Court was of the view that while the Constitution Bench in Jindal Stainless case had dealt with some aspects of the matter, certain other important constitutional issues remained to be examined especially because a conceptually and contextually different approach may be required vis-à-vis "transport cases" on the one hand and cases of "entry tax on goods" on the other.

The matter was accordingly placed before a five-Judge Bench of this Court in the case of ***Jindal Stainless Limited and Anr. Vs. State of Haryana and Ors. [(2010) 4 SCC 595]***, who briefly referred to the decisions in Atiabari, Automobile Transport cases and ***Keshav Mills Co. Ltd. Vs. CIT [(AIR 1965 SC 1636)]*** and a few others and referred the matters to a larger Bench for reconsideration of the judgment of this Court in Atiabari and Automobile Transport cases. The Court noted that the correctness of the view taken in the said two cases had been doubted as early as in the year 1975 in ***G.K. Krishnan Vs. State of Tamil Nadu [(1975) 1 SCC 375]***. The reference order briefly set out some of the questions that required consideration by a larger Bench.

Held:

By 7:2 majority, the Hon'ble Supreme Court answered the reference in the following terms:

- Taxes simpliciter are not within the contemplation of Part XIII of the Constitution of India. The word 'Free' used in Article 301 does not mean "free from taxation".
- Only such taxes as are discriminatory in nature are prohibited by Article 304(a) of the Constitution. It follows that levy of a non-discriminatory tax would not constitute an infraction of Article 301.
- Clauses (a) and (b) of Article 304 of the Constitution have to be read disjunctively.
- A levy that violates Article 304(a) of the Constitution cannot be saved even if the procedure under Article 304(b) or the proviso thereunder is satisfied.
- The compensatory tax theory evolved in Automobile Transport case and subsequently modified in Jindal Stainless case has no juristic basis and is therefore rejected.

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- Decisions of this Court in Atiabari, Automobile Transport and Jindal Stainless cases and all other judgments that follow these pronouncements are to the extent of such reliance over ruled.
- A tax on entry of goods into a local area for use, sale or consumption therein is permissible although similar goods are not produced within the taxing State.
- Article 304(a) of the Constitution frowns upon discrimination (of a hostile nature in the protectionist sense) and not on mere differentiation. Therefore, incentives, set-offs etc. granted to a specified class of dealers for a limited period of time in a non-hostile fashion with a view to developing economically backward areas would not violate Article 304(a) of the Constitution. The question whether the levies in the present case indeed satisfy this test is left to be determined by the regular benches hearing the matters.
- States are well within their right to design their fiscal legislations to ensure that the tax burden on goods imported from other States and goods produced within the State fall equally. Such measures if taken would not contravene Article 304(a) of the Constitution. The question whether the levies in the present case indeed satisfy this test is left to be determined by the regular benches hearing the matters.
- The questions whether the entire State can be notified as a local area and whether Entry tax can be levied on goods entering the landmass of India from another country are left open to be determined in appropriate proceedings.

Hope the information will assist you in your Professional endeavours. In case of any query/information, please do not hesitate to write back to us.

Thanks & Best Regards

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