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## Entry Tax- Constitutional validity of Entry Tax upheld by Supreme Court

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The Constitution Bench (comprising of 9 judges) of Hon'ble Supreme Court of India on 11 November 2016 pronounced one of the landmark judgement in the history of indirect taxes in India in the case of **Jindal Stainless Ltd.& Anr. vs. State of Haryana (Civil Appeal No. 3453 OF 2002)**.

### **Brief background of the case**

For every tax to be levied in India, the Central Government or State Government must be constitutionally empowered to do so. Entry 52 of List-II (State list) of the Seventh Schedule to the Constitution of India empowers the States to collect 'taxes on the entry of goods into a local area for consumption, use or sale therein'. By virtue of this authority, various States in India have enacted entry tax legislation by which the States collect taxes on the entry of goods into their States.

At this juncture, it is imperative to take note of Article 301 and 304 as provided in Part XIII of the Constitution of India which deals with 'Trade, Commerce and Intercourse within the Territory of India'.

Article 301 states that the trade, commerce and intercourse throughout the territory of India shall be free, subject to other provisions of Part XIII.

Article 304(a) states that regardless of anything contained in Article 301, the State legislature may by law:

- impose on goods imported from other States or the Union territories, any tax to which similar goods manufactured or produced in the State are subject;
- such tax is imposed so as not to discriminate between goods imported and goods manufactured or produced in the state.

Article 304(b) empowers the State to impose, by law, such reasonable restrictions on the freedom of trade, commerce or intercourse with or within that State as may be required in the public interest. However, the Bill or amendment for imposing such law shall not be introduced or moved in the Legislature of a State without the previous sanction of the President.

The concept of compensatory tax has been judicially evolved as an exception to Article 301 and the parameters of this concept were blurred considering earlier conflicting Supreme Court decisions.

Thus, the moot controversy involved in the present case is the constitutional validity of levy of tax on entry of goods into local areas comprising the States. This levy was challenged on the ground that the same violates the constitutionally recognised right to free trade, commerce and intercourse guaranteed under Article 301 of the Constitution of India.

### Question of law involved in the case

The questions invoked assume a great measure of considerable public importance not only because the questions dealt with the powers of the State legislatures to levy taxes but also because any pronouncement of the Apex Court is bound to impact the federal character of the Indian society and the Centre-State relationship in legislative and fiscal matters.

The questions of law were framed as under:

1. Can the levy of a non-discriminatory tax per se constitute infraction of Article 301 of the Constitution of India?
2. If answer to question No. 1 is in the affirmative, can a tax which is compensatory in nature also fall foul of Article 301 of the Constitution of India?
3. What are the tests for determining whether the tax or levy is compensatory in nature?
4. Is the Entry Tax levied by the States in the present batch of cases 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?

### Majority Conclusion

After a marathon discussion and deliberation, the Hon'ble Supreme Court, by majority, answered the reference in the following terms:

1. 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".
2. Only such taxes as are discriminatory in nature are prohibited by Article 304(a). It follows that levy of a non-discriminatory tax would not constitute an infraction of Article 301 of the Constitution of India.
3. Clauses (a) and (b) of Article 304 have to be read disjunctively.
4. A levy that violates 304(a) would be invalid even if the procedure under Article 304(b) or the proviso thereunder is satisfied.
5. The compensatory tax theory evolved in *Automobile Transport (Rajasthan) Ltd. etc. vs. State of Rajasthan & Ors. (AIR 1962 SC 1406)* and subsequently modified in *Jindal's* case has no juristic basis and is therefore rejected.
6. The constitution framework have provided for all exceptions under which freedom of trade, commerce and intercourse guaranteed under Article 301 can be overridden. The compensatory tax not being included as one of the exceptions, cannot be added as an exception by any judicial interpretation. The compensatory tax theory brings dichotomy which is inconsistent with the language employed in Article 301 of the Constitution of India.

7. 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.
8. Article 304(a) lays emphasis on 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, in a non-hostile manner, with a view to develop economically backward areas would not violate Article 304(a). 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.
9. 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 receive equal treatment. 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.
10. 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.

### **Dhruva Comments**

Levy of entry tax could be considered to be amongst the most litigious taxation levy in India. This levy has seen challenges before various High Courts as well as Supreme Court, more specifically before the Constitutional Benches of the Supreme Court.

This ruling which has been delivered by the constitutional bench finally puts at rest the raging controversy over certain issues like whether levy of entry tax is violative of freedom of trade, commerce

and intercourse and whether such levies need to satisfy the test of compensatory character. This decision has concluded, by way of a majority, that any levy of entry tax which is non-discriminatory in character would not be violative of Article 301 and 304(a) of the Constitution of India. The jury is still out on whether the impugned enactments pass the test of non-discrimination as the same would be decided by the regular bench. Several elements like eligibility to claim set-off, payment of central sales tax etc could play an important role in arriving at conclusion of non-discriminatory character which would be examined by the regular bench.

Also, the majority decision has left several other questions like what would constitute local area, whether the levy would apply on imports etc open and therefore, the same is yet to achieve finality. Although Hon'ble Justice R. Banumathi while delivering a separate concurring judgment also commented upon the following issues - 'local area' could constitute entire state and entry tax can be levied on goods imported from out of India. Whereas Hon'ble Justice DR D Y Chandrachud differed on the issue of what constitutes a 'local area' and opined that the same cannot be extended to mean the entire State. Since, the above issues have not been decided by the majority, the last word on this subject could also mean another round of litigations.

The current framework of levy of central sales tax and upholding of power to levy Entry tax, subject to it being non-discriminatory, by States essentially implies that we are living in a tax environment where the origin based as well as destination based consumption tax co-exist! Replacement by Goods and Services tax ('GST') laws would ensure there is a single framework i.e. destination based consumption tax.

Going forward, entry tax would be subsumed under GST. Hence the validity of levy may not have considerable implications under the GST regime. However, the principles and observations discussed in the judgment may still have significant bearing on

discussions concerning constitutional power of the States. Also, if it is ultimately held that the current entry tax laws pass the test of it being non-discriminatory, companies could be saddled with huge liabilities pertaining to the past periods. The strategy to deal with such situations under the GST regime therefore assumes great significance.

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