NOTES AND COMMENTS

SLIPPERY SLOPES OF COMPENSATORY TAX AND FEE

Abstract

Normatively, theoretically and legislatively three prominent tasks have been entrusted to taxation, namely, revenue augmentation, redistribution of wealth in society and regulatory function to ensure expected economic behaviour. Indian tax jurisprudence, however, witnessed an additional functionality to the aforesaid assignments with judicially evolved concept of 'compensatory taxes'. It was in response to protect taxing power of the state *vis-à-vis* freedom of trade and commerce contemplated under article 301, that Indian judiciary crafted compensatory taxes as exception to article 301.Compensatory tax premised on twin doctrines of 'proportionality' and 'direct and immediate effect', was in form a tax and in substance a fee. It ingrained 'proximate quid pro quo' and 'proportionality' as essential elements which have been traditionally reserved as a necessity for fee. Such colouring of tax with 'quid pro quo' reduced tax to the level of fee and negated the distinction between tax entries and fees, recognised in the Constitution. The difficulties deepen with understanding about fee undergoing transformation with 'remote quid pro quo' replacing 'proximate quid pro quo'. Even where Supreme Court's decision in *Jindal* case provides point of distinction between compensatory tax and fee based on targeted payers of the levy, it is crucial to examine post-*Jindal* position to decipher present state of affairs and explore whether the distinctions drawn by *Jindal* are of any consequence.

I Introduction

THE CONCEPT of tax and fee pose a queer case of stark similarities and sharp differences having interested and indulged economists, courts, scholars and litigants over a fairly long period. Normatively, theoretically and legislatively three prominent tasks have been entrusted to taxation, namely, revenue augmentation, redistribution of wealth in society and regulatory function to ensure expected economic behaviour. Fees, on the other hand, was assigned narrower scope of conferring some special benefit on payer or regulating purposes. Such neat division of functionality was thus premised on *quid pro quo*. Whereas tax was devoid of *quid pro quo*, it was a *sine qua non* for fee. This underlying distinction between tax and fee entangled with judicial evolution of the concept of compensatory tax. It was in response to harmonize taxing power of the state *vis-à-vis* freedom of trade and commerce guaranteed under article 301 of the Constitution, that concept of compensatory tax was propounded. While jurisprudence on compensatory tax was still emerging, the concept of fee departed from its traditionally accepted definition. On account of isolated developments, compensatory tax and fee reached such crossroads where compensatory tax engulfed some of the essential elements that were erstwhile considered to be an exclusive domain

of fee. Consequently, distinctions between compensatory tax and fee blurred to such an extent that it became difficult to determine true character of a levy and the difference, if any, remained only in nomenclature.

It was, however, crucial to maintain a distinction between the two since power to tax in the Indian Constitution was co-terminus with express taxing entries in the seventh schedule. Blurring of tax and fee in effect meant a serious compromise with the constitutionally recognised distinction. Supreme Court in *Jindal Stainless Ltd.* v. *State of Harayana*[1] finally demystified the cloud drawing a line of difference between compensatory tax and fee. It needs to be underscored that such distinction is not merely an academic pursuit rather a very significant constitutional issue.

It is in this backdrop that this paper aims to examine legal position on compensatory tax and fee post-*Jindal* decision. In the process, the paper engages with judicial evolvement of compensatory tax and fee which led to blurring of concepts. It analyses subsequent matters concerning compensatory tax and fees and whether the line of distinction drawn by *Jindal* is helpful in determining nature of levy. Part I introduces the paper, clearly stating goals and purpose of the paper. Part II provides an insight into basic contours of tax and fee, thereby identifying classical difference between the two. Part III seeks to analyze classical approach in fee and transformation undergone. Part IV analyse evolutionary phase of compensatory tax beginning with *Atiabari Tea Co. Ltd.* v. *Assam,*[2] and *Automobile Transport Rajasthan Ltd.* v. *State Of Rajasthan,*[3] moves on to discuss fallacies created by *Bhagatram*[4] and subsequent decisions which finally stood corrected by *Jindal* that gives compensatory tax its present shape. Part V discusses decisions that followed *Jindal* and clarifies present elements of compensatory tax. Part VI investigates, in the light of *Vijayalaxmi Rice Mill* v. *The Commercial Tax Officers, Palakol*[5] and more recent *Dravya Finance Ltd.*v. *Life Insurance Corporation of India,*[6] whether *Jindal's* decision could be extended to fee and whether it has any ramifications on fee. Part VII attempts to assess a real point of distinction between compensatory tax and fee and concludes the paper.

II Contours of tax and fee

Words and phrases take colour and character from the context and the times and speak differently in different contexts and times. And, it is worthwhile to remember

1 (2006) 7 SCC 241 (hereinafter *Jinda*l).
2 (1961) 1 SCR 809 (hereinafter *Atiabari*).
3 [1963] 1 SCR 491 (hereinafter *Automobile*).
4 (1995) Supp SCC 1 673 (hereinafter *Bhagatram*)
5 AIR 2006 SC 2897 (hereinafter *Vijaylakshmi Rice Mill*).
6 (2010)101 SCL 291(Bom) (hereinafter *Dravya Finance*).

that words and phrases have not only a meaning but also content, a living content which breathes, and so, expands and contracts. 'Tax' and 'fee' are such words. They properly belong to the world of public finance but since the Constitution and the laws are also concerned with public finance, these words have often been adjudicated upon in an effort to discover their content.[7]

As such it has been well recognised that both tax and fees are manifestations of state's taxing power. In order to have clarity of understanding, the author analyses available definitions. A tax is a compulsory contribution to the government, imposed in the common interest of all, for the purpose of defraying the expenses incurred in carrying out the public functions or imposed for the purpose of regulation, without reference to the special benefits conferred on the one making the payment.[8] A proper dissection of this definition leads to the essential characteristic of tax: i) that tax is a compulsory exaction of money by public authority ii) that such imposition is in common interest iii) that purpose of imposition may comprise either in augmentation of revenue or in attaining some regulation[9] and iv) absence of *quid pro quo*. A necessary corollary that follows is that tax being instrumental in revenue augmentation, its quantum need not commensurate with costs incurred by such public authority. Further, tax is devoid of any *quid pro quo*. Even where any benefit seems to flow, in case of tax, it is merely incidental and not primary. In other words, there exists no connection, whether direct and immediate or broad and casual between the contributor of tax and benefits.

In a glaring contrast, fee, is generally defined to be a charge for a special service rendered to individuals by some governmental agency. Ordinarily, fees are uniform and no account is taken of the varying abilities of different recipients to pay. It is well-settled that a fee may either be regulatory or compensatory.[10] Where a fee commensurate with the cost of rendering the service though not in 'exact arithmetical equivalence' it is compensatory fee. On the other hand a fee charged to regulate or control, is validly classifiable as regulatory fee, provided it is not excessive or not dominantly intending

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7 *Amar Nath Om Prakash* v. *State of Punjab,* AIR (1985) SC 218, para 9.

8 Martin T Crowe, *The Moral Obligation of Paying Just Taxes* 12 (Catholic University of American Press, Washington D.C., 1944).

9 In general the plenary objective of tax is to augment revenues for government, besides attaining redistribution of income and wealth, thereby achieving socialist pattern and positively influencing macroeconomics to attain stability. Power to tax may be exercised for the purpose of regulating an industry, commerce or any other activity; the purpose of levying such tax, an impost to be more correct, is the exercise of sovereign power for the purpose of effectuating regulation though incidentally the levy may contribute to the revenue. *Calcutta Municipal Corporation* v. *M/s ShreyMercentile Pvt. Ltd.* para 109.

10 See art.110(2) and art.199(2) of the Constitution that contemplates distinction between fees for services rendered and fees that are regulatory.

to raise revenues for the public authority.[11] It is well settled that "in the garb of exercising the power to regulate, any fee or levy which has no connection with the cost of or expenses of administering the regulation cannot be imposed".[12]

Thus it can be safely observed that so far as tax is concerned it can be regulatory in nature and a fee can be either compensatory or regulatory or combination of both. Whilst both tax and fee are compulsory exactions of money by public authority, their real distinction comprise in primarily what is known as *quid pro quo* test and proportionality of amount test.[13]

Whereas the Constitution connotes a very wide definition of 'taxation' *vide* article 366(28)[14] and largely accords that power to tax is inherent in sovereignty, it maintains that tax cannot be levied or collected except by the authority of law.[15] This authority of law to tax is found in article 245 read with corresponding legislative entries in schedule VII. Drawing a clear distinction between tax and fee, schedule VII to the Constitution in list I and list II enlist entries dealing with taxes and fees distinctly.[16]It is crucial to note that power to tax is confined to particular species of taxes distinctively specified in such lists and no general entry can be invoked for the purposes of imposing a tax. Fees can be charged as incidental to the exercise of legislative power on general entries in the list in schedule VII.[17]

Judicial evolution of compensatory tax premised on twin doctrines of 'proportionality' and 'direct and immediate effect' assumes form of tax while being fee in substance. On a close scrutiny one may observe that the aforementioned doctrines are nothing but the *quid pro quo* test and proportionality test which had been

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11 In *B.S.E. Brokers' Forum, Bombay* v. *Securities and Exchange Board of India* (2001) 3 SCC 482 it was held so far as the regulatory fee is concerned, the service to be rendered is not a condition precedent and the same does not loose the character of a fee provided the fee so charged is not excessive.

12 See *West Bengal* v. *Kesoram Industries* (2004) 10 SCC 201; *State of Uttar Pradesh* v. *Yarn Organic Chemicals,* AIR 2003 SC 4650; *BSE Brokers Forum* v. *SEBI* (2001) 3 SCC 482.

13 In economic sense of terms, however, a further distinction of tax and fee have been traced in the fact that a tax is levied as a common burden, based on ability to pay principle; a fee has its foundation in principle of equivalence whereby the quantum of benefit can be determined which form the basis of reimbursement/recompense to the authority levying it. *Supra* note 4.

14 Art. 366 (28) of the Constitution of India-"taxation" includes the imposition of any tax or impost, whether general or local or special, and "tax" shall be construed accordingly.

15 Art. 265 of the Constitution of India- Taxes not to be imposed save by authority of law. No tax shall be levied or collected except by authority of law.

16 In Union list entries 82 to 92A relate to taxes and duties, entry 96 demarcates the field for fees in respect of any of the matter in the said list not including fees taken in any court; in state list entries 46 to 63 relate to taxes and entry 66 provide for fees in respect of any matters in said list.

17 *Corporation of Calcutta* v. *Liberty Cinema,* AIR 1965 SC 1107.

distinguishing fee from tax. Consequently tax is reduced to the level of fee and this is problematic given the express distinctions between tax and fee and concomitant powers to levy these. Merging identity of compensatory tax with fee negates constitutionally recognised distinction and renders entries in schedule VII redundant. An already muddled legal position gets further complicated with transformation of fee as 'proximate quid pro quo' test is relaxed in favour of 'remote quid pro quo' test.

It is, therefore, extremely crucial to decipher what exactly is the distinction between compensatory tax and fee. The much celebrated decision of *Jindal* has sought to provide significant distinction, however it is crucial to examine post-*Jindal* decisions to have an insight whether distinction drawn in *Jindal* is of consequence. There are certain well settled postulates with regards to tax and fee which must be borne in mind before delving any further elaboration into this issue. One, nomenclature of a levy within a statue as 'tax' or 'fee' is not decisive since regardless of the expression used, tax may be levied in the name of fee. Two, whilst in regulatory fees *quid pro quo* is absent, it would not be a tax. In the same breath merely because tax has incidental *quid pro quo* will not make it a fee. Similarly merely because compensatory tax is proportional will not automatically lead to positive inference of it being a fee.

III Departure from classical approach of fee

Insofar as fee is concerned, *quid pro quo* was considered to be a *sine qua non*. This is time and again reiterated in numerous decisions.[18]Accordingly a levy to be identified as fee must have an element of *quid pro quo* between the payer and the public authority who imposed it. It can be catagorised as 'proximate quid pro quo'. An essence of classical approach of fee comprised in the following:

a) proximate *quid pro quo*[19] i.e. rendition of certain services to the payers by government agency which amounts to special benefit/advantage to the payer (the author distinguishes the same from incidental *quid pro quo* of tax);
b) proportionality *i.e.*, the amount imposed ought to commensurate with cost of services to be rendered;

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18 *The Commissioner, Hindu Religious Endowments, Madras* v. *Sri LakshmindraThirthaSwamiar of Sri Shirur Mutt* (1954) SCR 1005; *H. H. SudhundraThirthaSwamiar* v. *Commissioner for Hindu Religious and Charitable Endowments*, 873 Mysore [1963] Suppl. 2 SCR 302; *The Hingir-Rampur Coal Co. Ltd.* v. *The State of Orissa,* 1961 AIR 459; *Southern Pharmaceuticals and Chemicals Trichur* v. *State of Kerala* [1982] 1 SCR 519; and *Municipal Corporation of Delhi* v. *Mohd. Yasin,* AIR 1983 SC 617.

19 This is a term purely evolved by this author in order to facilitate understanding of confusion that prevailed on account of compensatory tax. By proximate *quid pro quo* the author means intimate and immediate nexus between rendition of service and payer who were also direct beneficiaries of such service, on one-on-one basis. Therefore, the term proximate is used so as describe the proximity between beneficiaries and services.

c) specific fund that ensures dedicated spending from an earmarked fund for specific purpose of that service. Merger of proceeds with general revenue to be spent for general purposes was not acceptable.[20]

d) primary objective that is to enquire whether the primary purpose of imposing levy is rendition of services and it is not merely incidental to augmentation of revenue. If latter predominates, it acts as negative restriction and the levy will be tax.

Applying these inherent characteristics, *Shirur Mutt* case[21] held that the levy on religious institutions was a tax and not fee on two fold grounds. First, there was total absence of any co-relation between expenses incurred by the government and amount raised by contribution resulting into non application of *quid pro quo*. Second, it was observed that the money raised by the levy of the contribution was not earmarked or specified for defraying the expense that the government had to incur in performing the services. All the collections were going to consolidated fund of the state and all the expenses were to be met not out of those collections but out of the general revenues by a proper method of appropriation as is done in case of other government expenses.

However, in *Hingir-Rampur Coal Co.*case[22] even where facts in the case depicted that the amenities to be provided were not of no direct consequence to the payers, the majority held in favour of the government. The proximate *quid pro quo* came to be slighted diluted when the majority led by Gajendragakar J held that the true test to determine whether a levy is fee is whether its primary and essential purpose is to render specific services to a specified *area or class*. The ratio of this judgment was reiterated by the three judge bench decision in *Sreenivasan General Traders* v. *State of A.P.*[23] Emphasising that traditional concept of actual *quid pro quo* has undergone a sea

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20 In *Chief Commissioner, Delhi* v. *Delhi Cloth & General Mills Co. Ltd.* (1978) 2 SCC 367, it was held that levy of fee should be in consideration of certain services which the individuals accept either willingly or unwillingly and that the collection from such levy should not be set apart or merged with the general revenue of the State to be spent for general public purpose but should be appropriated for the specific purpose for which the levy is being made.

21 *The Commissioner, Hindu Religious Endowments, Madras* v. *Sri LaxshmindraThirthaSwamiar of Sri ShirpurMutt* (1954) SCR 1005.

22 AIR 1961 SC 459 (hereinafter *Hingir*) Petitioners who were a class of mineral developers challenged the constitutional validity of the Orissa Mining Areas Development Fund Act, 1952, which by s. 3 empowered the state government to constitute mining areas for the purpose of providing them with certain amenities. The main thrust of arguments was on pith and substance of the Act as being an excise duty. It was therefore, at one point observed by the court that it was not the petitioners that there is no co-relation between the levy and that services were not genuine or real or that the levy was disproportionately higher.

23 AIR 1983 SC 1246 (hereinafter *Sreenivasan General Trader*).

change; it was held that all that is necessary is that there should be a "reasonable relationship" between levy of the fee, and the service rendered. However, there was no elaboration on what this 'reasonable' relationship was and how the same can be ascertained.

Echoing similar sentiments, *City Corporation*[24] and subsequent decisions[25]considered that *quid pro quo* in form of rendering services need not necessarily have a direct relation to particular individual from whom fee is being realized. In other words such relation need not be direct and a mere casual relation may be enough. It is not necessary to establish that those who pay fee must receive direct benefit of the services rendered for which fee are being paid. 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.[26]Thus, the test of co-relationship was reckoned at a generic level rather at an individual level. This shift may be termed as replacement of proximate *quid pro quo* with remote *quid pro quo*.[27]

The requisite of earmarking of funds was also diluted in subsequent case law. Merely because collections for services rendered or grant of a privilege or licence are taken to the consolidated fund of the state and not separately appropriated towards the expenditure for rendering the service is not by itself decisive.[28]

With proximate *quid pro quo* test replaced with remote *quid pro quo* test and the specific fund test being considered non-determinant factor, the only test that remained untouched from the classical package was proportionality test. This test coupled with primary object test became new determinants of fee. The modern approach to fee therefore consisted of three point check: (a) Primary object test- whether the plenary objective of the levy is rendition of service to specified class and this service is something other than something merely incidental; (b) Remote *quid pro quo* test- whether the payer receives a generic benefit from the authority imposing levy; (c) Proportionality test whether there exists a broad and generic co-relationship between services rendered

24 (1985) 2 SCR 1008.

25 *General Traders* v. *State of Andhra Pradesh*, 1983 AIR 1246; *City Corporation of Calicut* v. *ThachambalathSadasivan* (1985) 2 SCC 112; *Sirsilk Ltd.* v. *Textiles Committee* (1989) Supp. 1 SCC 168; *Commissioner & Secretary to Government Commercial Taxes & Religious Endowments Department* v. *SreeMurugan Financing Corporation Coimbatore* (1992) 3 SCC 488; *Secretary to Government of Madras* v. *P.R.Sriramulu* (1996) 1 SCC 345; *Vam Organic Chemicals Ltd.* v. *State of U.P.* (1997) 2 SCC 715; *Research Foundation for Science, Technology & Ecology v. Ministry of Agriculture* (1999) 1 SCC 655 and *Secunderabad Hyderabad Hotel Owners' Association* v. *Hyderabad Municipal Corporation, Hyderabad* (1999) 2 SCC 274; *Shivalik Agro,* AIR 2004 SC 4393.

26 *Supra* note 7.

27 Again this is the term evolved for the purpose of highlighting the difference brought about by subsequent decisions on fee. By remote *quid pro quo* what the author means is a broad/casual nexus between rendition of service and payer who is now a distant beneficiary. The term remote is used to describe the situation where services target beneficiaries which is a generic class comprising of certain free riders but inclusive of payers.

28 *Southern Pharmaceuticals supra* note 18 at 542.

and quantum of levy. Applying these tests classification between tax and fee could be fairly determined. So far all was well. However, real confusion prevailed with emergence of compensatory tax, a look alike of fee in all possible terms, as shall be discussed in the following part.

IV Evolution, dilution and demystification of compensatory tax

The concept of compensatory tax is a judicial evolution. It is imperative to understand this in the backdrop of part XIII of the Constitution. Article 301[29] of the Constitution provides for freedom of trade, commerce and intercourse throughout India. Although positively worded, article 301 implies a negative condition for the Union and states by way of casting a general limitation on their powers to formulate such laws which in effect restricted freedom of trade and commerce. This general limitation, however, is not an absolute one and certain relaxations were forwarded to the Parliament as well as state legislatures respectively. Under article 302[30] Parliament may, in public interest, impose restrictions on this freedom. Article 303(1) asserts that neither Parliament nor state legislatures can enact laws discriminating between states with respect to trade and commerce. Immediately in the next clause *vide* article 303(2) an exception is made in favour of Parliament alone to enable enactment of discriminating laws in case of scarcity. Article 304[31]carves out exceptions for state legislations by way of clause (a)that enables state legislations to impose tax on goods provided these are non-discriminatory and clause (b) that authorizes them to impose reasonable restrictions in public interest provided presidential sanction is sought.

There existed a controversy whether taxing statues came under the purview of article 301 or not. *Atiabari*[32] settled this debate when Supreme Court categorically

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29 Art. 301 - Subject to the other provisions of this Part, trade, commerce and intercourse throughout the territory of India shall be free.

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

31 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 interest: 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.

32 The statute which was challenged in *Atiabari* was the Assam Taxation (on goods carried by Roads and Inland Waterways) Act, 1954. It was held that the Act had put a direct restriction on the freedom of trade and since the state legislature had not complied with the provisions of art. 304(b), the Act was declared void.

held that even a tax legislation have to bear the scrutiny of part-XIII of the Constitution and such legislation could infringe articles 301 to 304 of the Constitution. It was observed that taxes may and do amount to restrictions but it is only such taxes as directly and immediately restrict trade that would fall within the purview of article 301.[33] Thus tax laws were considered to be well within the ambit of part-XIII of the Constitution. A workable test was put forth in terms of 'doctrine of direct and immediate effect' of the statute over freedom of trade and commerce. However, statutes found to be restrictive of trade could avoid invalidation if they complied with article 304(a) or (b).

The direct and immediate restriction test propounded in *Atiabari* had great adverse effect upon the financial autonomy of states. For instance, a law passed by a state legislature under entry 56 in list II, namely "taxes on goods and passengers carried by road or on inland waterways" would be a restriction which is immediate and direct on the movement part of trade and commerce and would be bad. This means that entry 56 in list II is rendered otiose.[34] When Supreme Court, within a year from the decision of *Atiabari*, delivered the decision of *Automobile*, it reiterated doctrine of 'direct and immediate effect' and crafted out an exception to requirements of article 304. Accordingly, 'regulatory measures and measures imposing compensatory taxes for use of trading facilities do not come within purview of the restriction contemplated by article 301'.[35] Compensatory taxes were held to be ones which did not hinder the freedom of trade, commerce and intercourse[36] instead facilitated the same. Thus working test for deciding whether a tax is a compensatory or not is to enquire (a) whether the trade is having the use of certain facilities for the better conduct of its business *i.e.,* direct and immediate effect doctrine and (b) paying not patently much more than what is required for providing the facilities *i.e.,* doctrine of proportionality.[37]

It is pertinent to note that aforementioned doctrines replicate proportionality test and proximate *quid pro quo* test applied to fees with 'direct and immediate effect' construed in terms of directly improving and facilitating trade, commerce and intercourse. Interestingly whilst propounding compensatory taxes, the 'separate fund test' and 'primary objective' test were rejected as unacceptable as determinants of compensatory tax.[38]

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33 *Supra* note 2.

34 See *G.K.Krishnan* v. *The State Of Tamil Nadu,* 1975 AIR 583.

35 *Supra* note 3 at 536.

36 *Ibid*

37 For detailed discussion see V. Niranjan, "Interstate Trade and Commerce: The Doctrine of Proportionality Reaffirmed" 2 *Ind J Const L* 201 (2008).

38 *Supra* note 3, paras 27 & 28. Whether a tax is compensatory or nor cannot be made to depend on the preamble of the statute imposing it. It is obvious that if the preamble decided the matter, then the mercantile community would be helpless and it would be the easiest thing for the Legislature to defeat the freedom assured by Art. 341 by stating in the preamble that it is meant to provide facilities to the tradesmen.... Nor do we think that it will make any difference

It is pertinent to note here that this seven judge bench decision in *Automobile* case, considered being fountain head of compensatory taxes in India, comprise three sets of opinion on the issue. Of the four majority judges, three — S.K.Das, Kapur and Sarkar JJ gave a common opinion through S.K. Das while Subba Rao J delivered a separate one. Subba Rao J referred to regulations such as police regulations, provision for services, maintenance of reads, provision for aerodromes, with or without compensation as creating conditions for the free movement of trade and identified impost under consideration as a regulatory in character.[39] The minority opinion on the other hand delivered by Hidayatullah, Ayyangar and Mudholkar JJ neither found the impost to be neither regulatory in nature nor compensatory. Apparently, even the majority upheld validity of the impost on differing grounds. Conceding such problematic nature of compensatory majority led by S.K. Das J observed, 'it would be impossible to judge the compensatory nature of a tax by a meticulous test'.[40] Evidently, compensatory tax and its determinants were found to be problematic since its inception.[41]

The problems were not far to seek. When *Bhagatram* and later on *Bihar Chamber of Commerce*,[42] widened the concept of compensatory taxes by diluting doctrine of direct and immediate effect and suggesting substantial or even some link between tax and facilities extended, it led to anomalies. This sudden onslaught of 'some connection' test was in direct clash with remote *quid pro quo* test of fee.

International Tourist Corporation[43] decision sought to engage with doctrine of proportionality under compensatory tax *vis-a-vis* fee. It was observed that if the tax were to be proportionate to the expenditure on regulation and service it would not be a tax but a fee. Interestingly, *International Tourist Corporation* hints towards a very basic level difficulty that may be encountered in compensatory tax *vis-a-vis* fee. It recounted *Automobile's* decision that had also flagged difficulty of judging compensatory nature of a tax by a meticulous test. It was pointed that while in the case of a fee it may be possible to precisely identify and measure the benefits received from the government and levy the fee according to the benefits so received and expenditure incurred; in the case of a regulatory and compensatory tax it would ordinarily be well nigh impossible to identify and measure, with any exactitude, the benefits received and the expenditure incurred and levy the tax in accordance with such benefits.[44] This view resonates with

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that the money collected from the tax is not put into a separate fund so long as facilities for the trades people who pay the tax are provided and the expenses incurred in providing them are born by the State out of whatever source it may be.

39 *Id.* at 493.

40 *Id.* at 536.

41 See M.P. Singh, "Freedom of Trade and Commerce v. Power of Taxation" 17 *JILI* 367 (1975).

42 (1996) 9 SCC 136.

43 AIR 1981 SC 774.

classical understanding of tax which categorically says that benefits, if any, following from tax is merely incidental.

In order to avert such difficulties of exact measure of benefit in compensatory and regulatory taxes, *International Tourist Corporation* suggested construing the benefit in broader fashion. Accordingly, if the object behind the levy is identifiable and if there is sufficient nexus between the subject and the object of the levy, it is not necessary that the money realised by the levy should be put into a separate fund or that the levy should be proportionate to the expenditure. Thus what was provided as a solution was remote *quid pro quo*.

Now here is exactly where the problem lies. Whilst a levy could be characterised as compensatory tax even with some link between the charge and facilities forwarded, whether directly or indirectly to the payer; the concept of fee was expanded to include a levy with a broad/casual co-relation between the services rendered and the charge imposed on the payer. The distinction, if any, remained only in nomenclature of the levy and not otherwise. This phase continued till the time *Jindal*'s decision was delivered.

Restoring doctrine of 'direct and immediate effect' in compensatory tax, Supreme Court in *Jindal's* decision held 'some connection' test to be bad in law. Further it was categorically stated that in order to qualify as compensatory tax, the enactment must facially or patently indicate quantifiable data on the basis of which such compensatory tax is sought to be levied. Thus compensatory tax was defined as a compulsory contribution levied broadly in proportion to the special benefits derived to defray the cost of regulation or to meet the outlay incurred for some special advantage to trade, commerce, and intercourse. It may incidentally bring in net revenue to the government but that circumstance is not an essential ingredient of compensatory tax.[45] Despite reverting to pre-*Bhagatram* position, there still remained a dilemma about distinction between a fee and compensatory tax.

Jindal's case made a magnificent contribution in this regards by demystifying the cloud surrounding the scope and application of compensatory tax. Moreover, perhaps for the first time cognizance was taken of the fact that compensatory tax and fee are akin to each other. It was categorically stated that compensatory tax is by nature hybrid but it is closer to fees than tax. Both compensatory tax and fee, which erstwhile were in a face off, were grouped together and their similarities and comparisons drawn with tax. Further, compensatory tax and fees were differentiated on the basis of target group of the impost. It was observed that a *compensatory tax is levied on an individual as a member of a class whereas a fee is levied on an individual as such.*[46]

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44 *Id.* at 374.

45 *Supra* note 4 at 242.

46 *Id.*, at 267.

What necessitates further inquiry is the tacit interpretation of this line of difference. Considering that Supreme Court has already settled in *Hingir* case and *Sreenivasan General Traders* case that true test of determining whether levy is fee is to inquire whether its primary and essential purpose is to render specific services to a specified *area or class',* is the aforementioned distinction in *Jindal* rendered redundant. Can it be inferred that the Supreme Court through in *Jindal's* decision restored not only compensatory taxes to its original position of direct and immediate doctrine and proportionality but also fee to its proximate *quid pro quo* position? The author raises this issue since *Jindal's* judgment whilst drawing difference between compensatory tax and fee seeks to make one-on-one match up in fees. It would be interesting to analyse developments post-*Jindal* and application of *Jindal's* ratio in both compensatory tax and fee.

V Compensatory tax post *Jindal*

Insofar as compensatory taxes are concerned, various appellate authorities and high courts have followed *Jindal's* decision.[47] In *Tata Steel Limited* v. *The State of Jharkhand,*[48]where liability was imposed to pay entry tax on value of scheduled goods imported in the state under Jharkhand Entry Tax Act, 2011, the high court followed *Jindal's* decision to hold entry tax to be *ultra vires* and unconstitutional. It was held that mere creation of dedicated trade development fund does not lead to an inference that entry tax is compensatory in nature. Where purposes of such fund did not directly facilitate trade and commerce and did not confer any special benefit to the tax payers; given absence of 'doctrine of direct and immediate effect', impugned entry tax cannot be held as compensatory tax.

Rapping knuckles of the state, high court starkly observed that the state government enacted the law in wilderness in hope that it may collect the tax and thereafter may appropriate the tax for the benefit and services of tax payers and that too, without there being any data base or project report.[49] The high court observed that state should have first collected quantifiable data to find out need of benefit and requirements of its meeting with levy of compensatory tax.

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47 See *Dinesh Pouches Ltd.* v. *State of Rajasthan,* 2007 (3) ILR (Raj) 201; *Sree Rayalaseema Alkalies and Allied Chemicals Ltd.*v.*State of Andhra Pradesh* (2008)13VST15(AP); *Jaiprakash Associates Limited (Cement Division)* v. *State of Arunachal Pradesh* (2009) 22 VST 310(Gauhati); *National Hydroelectric Power Corporation Ltd.* v. *A.C.C.T., Siliguri Charge* (2008)15 VST 158(WBTT); *Thressiamma L. Chirayil* v. *State of Kerala* [2007] 7 VST 293.

48 AIR 2012 Jhar 83. A division bench of High Court of Jharkhand in the case of *Tata Iron & Steel Company Ltd.* v. *State of Jharkhand* (2007) 6 VST 587 (Jhr.) had been dealing with similar enactment of state government and held against state government. Petitioners in present case contended that present enactment was verbatim reproduction of erstwhile Act.

49 *Ibid*

In *Tata Steel Limited* v. *The State of West Bengal*[50] it was held that to clear test of compensatory tax, onus lies on the state to show exact purpose or purposes for which levy was imposed, which should be identifiable, measurable, directly beneficial to *tax payers as class who*, would primarily be traders and manufacturers of local area, who import goods from outside state and/or outside country

In *ITC Limited* v. *State of Tamil Nadu* [51] a division bench of Madras High Court held that the Tamil Nadu Tax of Goods into Local Areas Act, 2001 did not satisfy the test laid down for compensatory tax. The high court observed that mere declaration in the preamble or statement of objects and reasons of an enactment that it is compensatory is of no consequence at all. The state was anyways under a general obligation to maintain roads and bridges from general revenue and there was no special benefit accruing to the payers of such entry tax.

While making enquiries into compensatory nature of taxes, the courts not only consider provisions of the statute but also data and other relevant material and evidenced to satisfy that levy provide specific, measurable benefits to the class of tax payers. Where states have failed to discharge 'direct and immediate effect' of facilities to trading community and measurable benefits based on pre-researched material, the impost have been struck down as being invalid and unconstitutional. There is a welcome surefootedness insofar as compensatory taxes are concerned whereby attempts of state government to pass of general benefits as specially targeted for trade and commerce are regularly discouraged. This leads to positive inference that proximate quid pro quo have been firmly reinstated as determination of compensatory taxes.

VI Ramifications of *Jindal's* decision *vis-à-vis* concept of fee

Whilst *Jindal's* case cleared the air regarding compensatory tax, it is crucial to examine whether observations made in *Jindal's* case regarding fee and compensatory tax have any ramifications on the concept of fee as such. In other words, could *Jindal's* case be resorted to in order to understand the nature of levy as a fee and whether classical approach which considered proximate *quid pro quo* as a *sine qua non* for fee holds good or not needs to be answered.

Soon after *Jindal's* decision, *Vijayalaxmi Rice Mill* came up before Supreme Court. The issue was whether imposition of cess under the Andhra Pradesh Rural Development Act, 1996 on individual traders engaged in business of rice milling was a fee or tax. Placing relevance on 'principle of equivalence' elaborated in *Jindal's* judgement, Appellants contended that there was no specific service rendered to the particular individual from whom fee has been realised and hence the levy was a tax

50 MANU/WB/0151/20139 (emphasis added).

51 (2007) 7 VST 367 (Mad).

not a fee. Rejecting this contention, the Supreme Court refused to extend *Jindal's* decision to the concept of fee in following words: [52]

> In our opinion the aforesaid decision cannot be interpreted to mean that the sea change which has taken place in the concept of fee has vanished, and that by this decision the old concept of fee(noted above) has been restored, and that now it has to be established that the particular individual from whom fee is being realised must be rendered some specific services. It may be noted that the decision in Jindal Steel (supra) was given in connection with Article 301 of the Constitution, and it was not regarding the nature of a fee. Hence it cannot be regarded as an authority explaining the nature of a fee.

Whilst appellants intended to apply proximate *quid pro quo* test post *Jindal's* decision, the court upheld modern approach of remote *quid pro quo*.[53] The ultimate test which the court seems to be in approval is the primary objective test and total absence of remote *quid pro quo*.[54]

Dravya Finance once again brought forth an opportunity before Bombay High Court to clarify its stand on dispute of levy being a tax or fee. In this matter, a circular was issued by Life Insurance Corporation in May 2007, imposing a charge of Rs. 250/- on transfer of life insurance policies to financial companies. This impost was challenged on the grounds that was *ultra vires* section 38 of the Insurance Act, 1938; it is generally without authority of law as the respondent has no power to issue the same and it is in violation of article 265 of the Constitution of India as it levies a tax or fee without the authority of law. The respondent Life Insurance Corporation contended that the imposition was a nominal amount charged to recompense itself for high costs of administration resulting from cumbersome administrative processes and tremendous manpower involved in servicing voluminous assignments of policies. Hence it was a

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52 *Id*, paras 15 & 16.

53 Since it was not specific averment was made by the appellants regarding total absence of any broad co-relation between the levy and services being rendered, the court left it open to the petitioners to file a fresh petition with this averment.

54 Thus it is now settled position of law that when the fee is paid for performing a functions or rendering a particular service, it is not to be considered as a tax, but if the object of the fee is to provide general revenue of the authority rather than to compensate it, and the amount of the fee has no co-relation to the value of the services, fee shall amount to a tax. Therefore, to find out whether a particular fee is charged as a fee for the service rendered or it is in the nature of tax, the court has to see if there is any co-relation between the fee and the service rendered.

fee and also produced evidentiary data. The central issue here was determination of nature of levy and whether the fact that the levy is compensatory necessarily makes it a fee.

The court, in the process of determining nature of the underlying impost, examined various essential elements and differences between tax and fee in a series of cases[55] which *inter alia* referred to primary objective test. Interestingly whilst narrowing down its scrutiny, court referred to the utility at which the amount was put and the target group to whom the services ultimately rendered: [56]

> [I]f the amount of Rs.250/- charged by the respondent No.1 for registration of every assignment of a policy is in the nature of administrative charges for general services being rendered by the LIC to its policy holders or assignees, it would amount to tax. Similarly, if it is a fee, which has no co-relation with the service being rendered to the *particular customer*, it will also amount to a tax and cannot be charged without the authority of law. However, if it is a fee in nature of charges for the services *rendered to the particular customer* and is *not for recovery of general administrative expenses* of the LIC, it may be treated as a fee or service charges.

Having thus premised preliminary inquiry on targeted beneficiaries, the court further sought to examine, as suggested in *Jindal's* case, the proximate *quid pro quo*. Placing reliance on the data and material furnished by LIC, high court observed that on account of huge number of requests for assignment of policies there has been increase in administrative work of LIC. Consequently, high court held that what is Rs.250/- charged 'is only a service charge or a fee for the service being *rendered to the persons making requests for registration of assignment*'.[57] This is so even where it may not be possible to specifically provide for mathematical equivalence between expenditure on individual case and amount charged. Thus it can be examined that *Jindals*' distinction was applied in spirit, however there was no express relevance placed.

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55 In *Krishna Das* v. *Town Area Committee, Chirgaon* (1990) 3 SCC 652 the court observed: "A fee is paid for performing a function. A fee is not ordinarily considered to be a tax. If the fee is merely to compensate an authority for services performed or as compensation for the services rendered, it can hardly be called a tax. However, if the object of the fee is to provide general revenue of the authority rather than to compensate it, and the amount of the fee has no relation to the value of the services, the fee will amount to a tax".

56 *Id.*, para 17 (emphasis added).

57 *Id*, para 29 (emphasis added).

VII Conclusion

It emerges from the discussion so far that despite *Jindal's* decision drawing a line of difference between compensatory tax and fee, there appears fair amount of reluctance in the subsequent decisions to directly acknowledge and apply the *Jindal's* decision insofar as fee is concerned. While much clarity has emerged post-*Jindal* decision on compensatory tax, greater obscurity prevails in matters of fee. A good opportunity seems to have been lost to create a stronghold on the contentious ground owing to the complexity of the issue.[59]

Compensatory tax and fee have traversed through numerous phases over all these years. Evidently, compensatory tax has been restored to its original position, however, there still remains ambiguity on whether *Jindal's* decision has restored fee to classical proximate *quid pro quo*. One observes judiciary walking a tight rope whilst delineating the two. Perhaps the difficulty in drawing any distinction arises from the fact that determination of nature of levy is an exercise that takes place subsequent to its imposition. So that variety of tests evolved are reactionary rather than precursors to imposition. In other words, one works backwards to decipher the exact nature of levy thereby breaking down each of building blocks rather than working forwards with joining of such blocks. Having said this, reading both the latest propositions together may aid in having a better insight into the issue.

Assimilating similarities and differences between compensatory tax and fee in the light of current legal position, it can be conveniently inferred that principle of equivalence and proportionality remains common elements for both compensatory tax and fees. One may delineate difference between on two fold grounds. First, *quid pro quo test* could be applied to determine the nature of levy. Thus, compensatory tax requires proximate *quid pro quo i.e.*, special advantage or benefit to trade as is evident from several high court decisions post *Jindal*. On the other hand, one may positively infer about a levy being a fee on identification of a remote *quid pro quo*. Second, taking a cue from *Jindal's* decision, what needs to be further scrutinized is who are *target payers and beneficiaries*. An impost is compensatory tax so long as levy is on members of a class, while imposition of levy on an individual as such makes it a fee.

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58 In *Dravya Finance* case whilst the court held that the impugned circular charges a service charge/ fee, since under s. 48(2)(k) of the LIC Act, conferred the power to levy a fee to the Central Government, the same could not be delegated to LIC without express provisions in the Act. Consequently, without there being a power to charge a fee, the impugned circular on that count has to be held illegal and unconstitutional as it violates art. 19(1)(g) and 300-A and to that extent, the petition has to be allowed.

The issue, however, seeks to be far from settled. The Supreme Court in the case of *Jaiprakash Associates Ltd.* v. *State of M.P.*[59] has referred the issue of scope of compensatory taxes to a larger bench. Interestingly, questions referred to the larger bench *inter alia* seeks yardsticks to be followed for determining compensatory character of the entry tax and includes a query whether *quid pro quo* relevant to fee applies to taxes imposed under part XII. To conclude, compensatory tax and fee are two distinct species of the same genre. However, determination of their distinction has proved to be a slippery slope. Supreme Court's decision on *Jaiprakash Associates* may bring in the much required clarity on the issue.

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59 (2009)7 SCC 339.

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