CHAPTER VI

STATE SALES TAX LAWS: INTRASTATE SALE TRANSACTIONS

The states could use sales taxes as a means to discriminate against the goods or commerce of the other states to the economic advantage of themselves. How that could be done has been seen in Chapter I. In order to guard against this danger the constitutional guarantee is provided by Art. 304(a) which states that "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." It is thus apparent that because of their constitutional invalidity such laws which discriminate against imported goods cannot remain in operation for long In *Umarao Lal Subalal* v. *State of M.P.*[1] the tax was levied on imported "bura sugar" and not on "bura sugar" manufactured locally. The court held the provision to be bad under Art. 304 (a) of the Constitution since the imported "bura sugar" was discriminated against. Conversely if instead of state of market, state of origin discriminates against goods going out of the state, the tax would be bad. Thus in *Bheru Lal* v. *State of Rajasthan*,[2] the state had imposed a royalty tax on stones produced in a particular local area but the rates differed according to whether the stones were consumed in that local area or were exported. Higher rates were charged on the latter. The court found the tax discriminatory against exports and held it invalid under Art. 303 of the Constitution which provides that no law of a state shall discriminate between one state and another.

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1. (1960) 11 S.T.C. 337. So also in *Bhai Lal Bhai* v. *State of M.P.*, (1960) 11 S.T.C. 511, imported tobacoo was subject to tax by the state but locally grown tobacco was exempt. On these facts the Madhya Pradesh High Court held that Art. 304 (a) was violated

2. A.I.R. 1956 Raj. 161.

A discrimination may be involved not only when a discriminatory tax is imposed but also when a tax on a substitute in intrastate commerce is imposed, but not one on the competing local commodity. A conspicuous illustration is provided by the following American example. A keen competitor to butter is oleomargarine. Almost from the time of its introduction into the United States in the early 1870's federal and state tax laws and regulatory laws have been applied to the manufacture and sale of oleomargarine. With commercial butter production largely concentrated in certain "dairy states" and production of margarine also somewhat concentrated, the actual effect of the laws was to raise appreciable barriers to interstate trade in oleomargarine. The Supreme Court of the United States upheld a higher tax on oleomargarine than on butter.[3] Such a tax will not be bad under Art. 14 of the Constitution of India providing equality before the law because one commodity is different from the other and no question of unreasonable classification arises in such a case.[4] However, it might be challenged under Art. 19 (1) (g) giving the citizens the right to practice any profession or to carry on any occupation, trade or business. It may not be possible to challenge it under Art. 304 (a) as already seen in Chapter IV.

The examination of the sales tax statutes of the states in India does not reveal any serious problem regarding interstate barriers. However, some of the provisions in the state laws which may create interstate barriers are considered below.

(i) An example of discrimination against goods going out of the state is provided by Section 15 (1) (b) (i) (b)[5] of the Assam Sales Tax Act according to which purchase of raw materials by the manufacturer will be exempt from sales tax if the finished product is sold within the state and not when it is

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3. *Helvering* v. *Lerner Stores Corp.*, 314 U.S. 463 (1941).

4. See, *supra*, p. 17, f.n. 20.

5. It provides that the net taxable turnover shall be determined by deducting from a dealer's gross turnover, during any given period, his turnover during that period of goods sold by him to a registered dealer for "use in the manufacture or production of any goods the sale of which is taxable under this Act."

sold outside. The justification for this rule appears to be that the finished product sold within the state will be ultimately subject to the local tax whereas it will not be so when it is sold in interstate commerce directly by the manufacturer. This is a method of getting revenue from locally manufactured goods sold outside the state while at the same time avoiding double taxation of the locally produced commodity—first as raw materials and then as finished product. However, the method involves an unjust discrimination against interstate commerce for the tax is levied only if the commodity is exported out of the state.[6] The finished product will be paying only one tax when sold intrastate but when the product is sold interstate, there will be first a tax on raw material; then a central tax of a minimum of 7 per cent when the finished product is sold either to an unregistsred dealer or to a consumer, or a central tax of 1 per cent when it is sold to a registered dealer and a further tax of the importing state on sales of the registered buyer.

(ii) The State of Rajasthan imposes a single point tax. On many commodities it is imposed at the last stage, i.e. when the goods are sold to a consumer or an unregistered dealer. No tax is imposed on sales made to registered dealers. However, section 2 (s) (iv)[7] provides that such sales will be exempt only when the registered dealer is purchasing for resale within the state. If he is purchasing for resale in interstate commerce, no exemption is given. Thus on the face of it there is a discrimination against interstate commerce. It might be argued that no discrimination is involved because the commodity sold in intrastate commerce is ultimately going to be taxed. But then answer to this is that the commodity sold in interstate commerce also is taxed under the Central Sales Tax Act and on its resale in the state of destination.

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6. *See Fernandez* v. *State of Travancore-Cochin*, (1955)6 S.T.C. 22: A.I.R. 1955 T.C. 126. Cf. Supreme Court's opinion in the same case, (1957)8 S.T.C. 561: A.I.R. 1957 S.C. 657. However, the Central Sales Tax Act was not in operation in the year for which liability of tax on the assessee was in dispute in this case.

7. Rajasthan Sales Tax Act. See also section 15 (1)(b)(i)(a) of the Assam Sales Tax Act and section 5 (2)(a)(ii) of the Bengal Finance (Sales Tax) Act, which have similar provisions.

Further, it could also be argued in favour of the state statute that had the state selected the first stage of sale for taxation irrespective of the fact whether the commodity bought by a dealer within the state is ultimately sold in intrastate or interstate commerce, it would have been bearing the local tax though sold in interstate commerce and no question of discrimination might have arisen. But, on the other hand, if the local manufacturer had sold the commodity in interstate commerce directly, it would not have been bearing any local tax. The important thing is what the state has done and not what it could have done. With respect, then, to the particular situation under consideration, the state has selected the last stage single point tax and the condition of exemption from tax is sale to a registered dealer for resale within the state, and therefore, discrimination is involved against goods going out of the state. Such tendencies by the states are to be deprecated, since the commodity is ultimately going to be taxed under the Central Sales Tax Act or the tax law of the importing state or under both.

(iii) One obvious way to discrimination against out-of-state products will be to charge a lower tax on, or to totally exempt from tax sales of commodities produced within the state, while not doing so in case of commodities produced outside. Thus Rajasthan provides that "locally manufactured gold and silver gota, salma, sitara and badla" will be exempt from tax.

Further, various states give perference to co-operatives and certain types of production (e.g., handmade products as against machine made products). There cannot be any particular objection against this form of concession from the point of view of interstate barriers, as the concession will extend to imported products also.[8]

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8. Taxation Enquiry Commission was opposed to the use of sales-taxes as a means to encourage a particular industry. It pointed out: ". . . sales tax concessions are hardly a suitable method of encouraging particular industries, trades, activities, etc. Even where such encouragement through tax concession is deemed to be both essential and in conformity with national economic policies, care should be taken to ensure that the exemption does not lead to evasion or abuse." Report, *Taxation Enquiry Commission* (1953), vol. III, p. 66.

However, discrimination is involved when, for example, the State of Uttar Pradesh provides that "locks and their parts manufactured in Uttar Pradesh when sold by the manufactures thereof" will be exempt from tax. This is clearly done to encourage the manufacture of locks within Uttar Pradesh. It is done under section 4-A of the Uttar Pradesh Sales Tax Act which states: "Where the State Government is of the opinion that it is necessary so to do for increasing production of any goods, it may by notification in the official Gazette declare that the turnover in respect of such goods by the manufacturer thereof shall during such period, not being less than three years but not exceeding five years, as may be specified, be exempt from sales tax or be liable to tax at such reduced rate as it may fix. . . ." Such provision is obviously to encourage the growth of industries in U.P. This provision, it appears, does not apply to an outside manufacturer, and if he brings his goods to U.P. and makes a sale he would be subject to tax. Further, assuming that the provision applies to an outside manufacturer also, it will still be discriminatory against such a manufacturer. For a local manufacturer, being situated within the state, might make all his sales himself to consumers, thus eliminating all sales taxation from marketing of his goods, whereas it is difficult for a manufacturer in interstate commerce to do so, and in normal course he would have to sell to a dealer of the state who in turn would sell to consumers in Uttar Pradesh thereby subjecting the transactions to tax.[9]

(iv) A few states require a minimum turnover for dealers before their liability under the sales tax Act accrues, but the agents of non-resident dealers are taxed irrespective of any turnover. Thus section 5 of the Andhra Pradesh General Sales Tax Act provides that every dealer (other than a casual trader and an agent of a non-resident dealer) whose total turnover for a year is not less than Rs. 10,000/- and every casual

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9. Uttar Pradesh Sales Tax Act also provides that *Kalabattu* manufactured in that State and sold by the manufacturers thereof will be exempt from sales tax. Few of the other examples of such exemptions are: Madras, sales of handmade paper (including cardboard) by certain Government Handmade Paper Units: Bombay, Handmade Paper when sold by the manufacturers, etc.

trader or agent of a non-resident dealer, whatever be his turnover for the year will be liable to pay sales tax.[10] This rule is apparently intended to discourage a non-resident dealer from appointing a number of agents in a state to effect sales through them only to escape the sales tax of that state although his total sales in the state is more than Rs. 10,000/-.

But will the above provision accomplish the objective? Agents could be broadly classified into (1) brokers, and (2) commission agents. A broker is an agent employed to make a bargain for another and receives a commission on the transaction which is usually called a brokerage. He has usually neither the custody nor the possession of the goods. It is the broker's duty to establish privity of contract between the principal and the third party. The broker cannot sell in his own name nor can he sue on the contract.[11] The broker cannot be assessed to sales tax, for he merely arranges the sale but does not make sale on his behalf, and it is immaterial whether he acts for a resident or a non-resident principal. In *Mahadayal Premchandra* v. *Commercial Tax Officer, Calcutta,*[12] the Supreme Court held that the agent who merely convassed orders on behalf of the principal was not liable to tax, even though the West Bengal sales tax law had provided that "the manager or an agent in West Bengal of a dealer who resides outside West Bengal and carries on the business of selling goods in West Bengal shall, in respect of such business, be deemed to be a dealer. . . ." Since the broker does not carry on the business of buying or selling, he cannot be subject to the sales tax. The provision in question does not apply to sales made through brokers.

A commission agent on the other hand has, according to the accepted mercantile practice, control over or possession

10. Other examples are, sec. 3 of the Madras General Sales Tax Act, 1959; Sec. 9(ii) of Mysore Sales Tax Act, 1957.
11. *Radhakrishna Rao* v. *Province of Madras,* (1952) 3 S.T.C. 121: A.I.R. 1952 Mad. 718.
12. (1958) 9 S.T.C. 428: A.I.R. 1958 S.C. 667. See also *State of Bombay* v. *Ratilal & Bros.,* (1961) XII S.T.C. 18: A.I.R. 1961 S.C. 1106 where the Supreme Court held that an agent who merely arranged sales between the seller and the disclosed purchaser could not be subject to sales tax since he was not carrying on the business of sale of goods.

of the goods and has the authority from the owner of the goods to pass the property in and the title to the goods. When the commission agent sells goods belonging to his principal with his authority and consent and without disclosing to the buyer the name of the owner, there is certainly a transfer of property in the goods from the commission agent to the buyer.[13] A commission agent doing this kind of business, therefore, can be deemed to be making a sale and can be taxed on his turnover. Section 5 of the Andhra Pradesh Act certainly covers commission agents.

It is very difficult for a non-resident principal to evade the sales tax by making sales through different commission agents for the turnover to be taxed is that of the agent and not of the principal and usually the total turnover of the commission agent will be much larger than the turnover of a particular principal selling through him. It will be indeed very difficult for a non-resident principal to find many commission agents who will be willing to deal exclusively in his goods and whose turnover will be below the minimum taxable limit of Rs. 10,000/-. But the same remote possibility of evading tax by the above arrangement is present not only in the case of a non-resident dealer but also a resident dealer who has branch in another state and gets goods on branch transfers and then makes sales through such commission agents. It is suggested that in effect the above provision of law involves a discrimination against non-resident principals and should have no place in a sales tax statute.

(v) The state laws can also create barriers to interstate trade and commerce by adopting a dual standard for levying of sales tax on the minimum total turnover or gross sales receipts of the dealers. Thus quite a few states provide a higher minimum taxable turnover on which sales tax is levied for a dealer who is dealing in goods produced within the state, and a lower limit for a dealer who is dealing in imported goods. Thus in Punjab the minimum turnover limit for an importer is nil, for a manufacturer it is Rs. 10,000 and for other dealers it is Rs. 50,000.[14] Similar provisions exist in various other

13. Supra f.n. 11, at p. 723.

14. Sec. 4(5) of the East Punjab General Sales Tax Act.

states.[15] The reason as stated in the Report of the Taxation Enquiry Commission, is that "unless the limit for registration was adequately low, the unregistered—and therefore non-tax paying—importer would tend to spring up in larger numbers to the deteriment of the registered importer as well as of the revenue of the State."[16] Now, since under the Central Sales Tax Act these unregistered importers would have to pay tax on their purchases, it would not be possible for such importers to "spring up" merely to evade the taxes of the importing state. The lower limit for an unregistered dealer would discourage him to import goods from outside his own state, and, therefore, this unjust discrimination against the small importers should be done away with.

It seems, if and when legal conflict arises on this point such a provision would be declared unconstitutional by the courts. In this respect *Bharat Automobiles* v. *State of Assam* [17] is worth nothing though the case is not on all fours with the above problem. In this case the State of Assam had provided that the commissioner could in his discretion require an importer to get himself registered under the Act even though he was not ordinarily liable to registration (because of his turnover being less than the prescribed minimum). The

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15. For instance, section 3(1) of the Rajasthan Sales Tax Act provides the minimum limit for an importer of Rs. 5,000/-, for a manufacturer or producer Rs. 10,000/ and for other dealers Rs. 12,000/-. Uttar Pradesh requires a minimum turnover of Rs. 12,000/- for registration of dealers. However, if a dealer is selling any imported goods and the goods are liable to single point tax, then the dealer is liable to tax irrespective of the quantum of his turnover.

    Further the sales tax laws of quite a few states have turnover limits for minufacturers and importers different from that for other dealers, e.g., section 4(5) of the Bengal Finance Act as extended to Delhi provides a limit of Rs. 10,000/- for an importer and manufacturer and Rs. 30,000/ for other dealers. See also section 3(4) of the Bombay Sales Tax Act, section 4(5) of the Bengal Finance (Sales Tax) Act and section 4(5) of the Madhya Pradesh General Sales Tax Act, 1958. These provisions naturally discourage a small dealer to import goods from outside the state.

16. *Taxation Enquiry Commission Report.*, op. cit., p. 11.

17. (1957)8 S.T.C. 537: A.I.R. 1957 Assam 1.

Court found such a provision to be bad under Art. 304(a) of the Constitution as being discriminatory against interstate commerce. The Court observed: "The dealer who obtains from outside any such goods, is liable to be taxed under sec. 29, whereas if he sells these things manufactured or produced in the State, he would not be liable to be taxed . . . under the provisions of the Act. It thus clearly makes a discrimination as against the dealer in respect of goods obtained from outside the State and creates a situation to his detriment, and is obviously hit by the constitutional bans referred to above."[18]

(vi) A number of state statutes provide that a dealer registered under the Central Sales Tax Act and purchasing goods in interstate commerce at a concessional rate will be liable to pay tax on sale of such goods, irrespective of any minimum turnover of the dealer.[19] A dealer registered under the Central Act could purchase goods in interstate commerce at a concessional rate of 1 per cent or the rate of the exporting state if the local tax in the exporting state is lower than 1 per cent but he would be liable to the local tax of the importing state on his further sales within the state if he was a registered dealer under the local act. A dealer registered under the Central Act may not be registered under the local act and if that is so he will not be subject to the local tax on his sales within the state, though he could buy the goods in interstate commerce at a concessional rate of 1 per cent. Therefore, such a provision equalises the two situations—namely, of a dealer registered under the Central Act as well as the state act, and a dealer registered under the Central Act but not under the state act—and though it looks discriminatory on the face of it against interstate commerce it has in fact been enacted to check discrimination against particular interstate transactions. This is an example where the judiciary should pierce the formal veil of discrimination and uphold the state law.

Many states, it may be noted, provide that a dealer registered under the Central Act is liable to pay tax irrespective of his turnover, on all sales effected by him.[20]

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18. *Ibid*, p. 545.
19. See *supra*, p. 21, f.n. 5.
20. *Supra*, p. 21, f.n. 6.

Under such a provision tax will be imposed on the sale of a commodity even though no interstate purchase has been made by the dealer. This obviously goes beyond the requirement of the situation and is discriminatory in operation against interstate commerce. Such a provision will discourage a small dealer to make interstate sales for as soon as he does so he becomes liable to pay tax to the state government on his total sales which would have been exempt otherwise from liability to the government.