CHAPTER II

HISTORY OF TAXATION OF INTERSTATE SALE TRANSACTIONS

The Government of India Act, 1935 gave power to the provinces to levy "taxes on the sale of goods and on advertisements".[1] In exercise of this legislative power, various provincial legislatures enacted sales tax laws for their respective territories.[2] Section 297 (1) (b) of the Act provided that in the levy of taxes, no province might discriminate against goods produced or manufactured outside the province. Except this section, there was no provision in the Government of India Act which restricted or prohibited the provinces from levying taxes on interstate transactions and which required the provinces to levy tax only on those transactions which exclusively took place in their respective territories. Accordingly, the provinces levied taxes on sale of good even though only one or two ingredients of sale had taken place within their respective territories. This was done on the theory of "territorial nexus". In *Tata Iron & Steel Co. Ltd.*, v. *State of Bihar*,[3] the Supreme Court of India recognised that a state could levy sales tax on a transaction of sale where all the ingredients of

---

1. List II, Entry 48.
2. The sales tax was first introduced in Madhya Pradesh in 1938 in the form of "petrol tax." It was, however, Madras which first imposed a General Sales Tax in 1939. By 1948, general sales taxes became prevalent in almost all the states. Now, there is no state without sales tax.
3. (1958) 9 S.T.C. 267: (1958) S.C.R. 1355: A.I.R. 1958 S.C. 452. Also see, *Poppatlal Shah* v. *State of Madras*, A.I.R. 1953 S.C. 274, where the Supreme Court said that it would be quite competent for a province to enact legislation imposing taxes on transaction concluded outside the province provided that there was a real territorial nexus between such transactions and the taxing province. In *Tobacco Manufs. (India)* v. *Commr. of Sales tax, Bihar*, A.I.R. (1957) Pat. 288, the passing of title and delivery of the goods within the state were held to satisfy the requirements of "territorial nexus."

sale had not taken place within it, provided there was sufficient territorial nexus between it and the sale. It held that the presence of goods at the date of agreement for sale in the State of Bihar or the production or manufacture of goods in that state provided a sufficient territorial nexus for that state to levy a tax on such a transaction of sale. The result of the nexus theory was multiple taxation of the same transaction by different provinces. The position existing on the eve of the Constitution is well summarised in the following observations of the majority opinion in *State of Bombay* v. *United Motors* [4].

> "In exercise of the legislative power conferred upon them in substantially similar terms by the Government of India Act, 1935, the Provincial Legislatures enacted sales tax laws for their respective Provinces, acting on the principle of territorial nexus referred to above; that is to say, they picked out one or more of the ingredients constituting a sale and made them the basis of their sales tax legislation. Assam and Bengal made among other things, the actual existence of the goods in the Province at the time of the contract of sale the test of taxability. In Bihar, the production or manufacture of the goods in the province was made an additional ground. A net of the widest range perhaps was laid in Central Provinces and Berar where it was sufficient if the goods were actually 'found' in the province at any time after the contract of sale or purchase in respect thereof was made. Whether the territorial nexus put forward as the basis of the taxing power in each case would be sustained as sufficient was a matter of doubt not having been tested in a court of law. And such claims to taxing power led to multiple taxation of the same transaction by different provinces and the culmination of the burden falling ultimately on the consuming public".

In order to remove the chaotic position and multiple taxation of the same transaction existing then, the Constitution of India by Art. 286 made provision for the regulation of

4. (1953) 4 S.T.C. 133, 142: (1953) S.C.R. 1069: A.I.R. 1953 S.C. 252.

interstate sales taxation.[5] Art. 286 was held to prevent the exporting state from imposing sales tax on goods sent to another state in *State of Bombay* v. *United Motors*.[6] In that case, the Supreme Court observed: "On the construction we have placed upon that Explanation, sales or purchases effected in Bombay in respect of goods in Bombay but delivered for consumption outside Bombay are not taxable in Bombay". However, the Court, in the same case, interpreted the provisions of Art. 286 so as to permit the importing state to tax a transaction of sale or purchase even though it took place in the course of insterstate trade or commerce and even though

---

5. Art. 286 before its amendment in 1956 was as follows:

(1) No law of a State shall impose, or authorise the imposition of a tax on the sale or purchase of goods where such sale or purchase takes place—

(a) outside the State: or

(b) in the course of the import of the goods into, or export of the goods out of the territory of India.

Explanation.—For the purposes of sub-clause (a), a sale or purchase shall be deemed to have taken place in the State in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of consumption in that State notwithstanding the fact that under the general law relating to sale of goods, the property in the goods has, by reason of such sale or purchase, passed in another State.

(2) Except in so far as Parliament may by law otherwise provide, no law of a State shall impose or authorise the imposition of, a tax on the sale or purchase of any goods where such sale or purchase takes place in the course of interstate trade or commerce.

Provided that the President may, by order, direct that any tax on the sale or purchase of goods which was being lawfully levied by the Government of any State immediately before the commencement of this Constitution shall, notwithstanding that the imposition of such tax is contrary to the provisions of this clause, continue to be levied until the thirty-first day of March, 1951.

(3) No law made by the Legislature of a State imposing or authorising the imposition of, a tax on the sale or purchase of any such goods as have been declared by Parliament by law to be essential for the life of the community, shall have effect unless it has been reserved for the consideration of the President and has received his assent.

6. (1953) 4 S.T.C. 133, 153.

the person to be taxed was resident outside its territory, provided that the goods were delivered in the importing state for the purpose of consumption therein. The effect of the decision was to create administrative difficulty for the business community as it made the dealer situated in the exporting state amenable to the sales tax law of the importing state. Importing states started to levy tax on those sale transactions where the goods were delivered in their respective areas for purpose of consumption therein. This led to the assessment of and collection of tax from selling dealers not situated in the importing state.

The difficulties that resulted were briefly pointed out by the Supreme Court in the subsequent case of *Bengal Immunity Co. v. State of Bihar*[7] thus:

> "All big traders will have to get themselves registered in each State, study the Sales Tax Act of each State, conform to the requirements of all State Laws which are by no means uniform and, finally, may be simultaneously called upon to produce their books of account in support of their returns before the officers of each State. Anybody who has any practical experience of the working of the sales tax of the different States knows how long books are detained by officers of each state during assessment proceedings. . . The harassment to traders is quite obvious and needs no exaggeration".

In that case, the court held broadly that no state could tax a transaction of sale or purchase taking place in the course of interestate trade or commerce, and it overruled the *United Motors* case, in so far as it had permitted the importing state to tax a transaction of sale or purchase when the goods were delivered therein for the purpose of consumption.

The *Bengal Immunity* case, although it put an end to the difficulties previously experienced by the traders by making interestate sales immune from taxation, nevertheless gave rise to a few complicated problems in its wake. Various importing states had imposed sales tax on interstate sales by non-resident dealers on the basis of the *United Motors* case.

---

7. (1955) 6 S.T.C. 446, 491: (1955) S.C.R. 603: A.I.R. 1955 S.C. 661.

The result of the *Bengal Immunity* case was that such a tax became unauthorised and the states were faced with large claims for restitution of the amounts realised, involving a threat to their economic stability. It should also be mentioned that quite a large number of dealers had, acting under provisions of the sales tax acts which empowered them to pass the tax on, collected it from their purchasers for the purpose of payment to the state, and as, after the decision in *Bengal Immunity* case, they could no longer be called upon to pay it, they stood to make an unjust gain of it.[8] To meet the contingency, the President promulgated Ordinance III of 1956, which was followed by the "Sales Tax Laws Validation Act VII of 1956"[9] — an Act passed under the power conferred on Parliament under Art. 286(2) of the Constitution.[10] By virtue of this enactment, the levy and collection of taxes already made by the various states during the period from April 1, 1951 to September 6, 1955 were legalised. Further, the Act also kept in force the sales-tax laws of the states in respect of interstate sales which had taken place during that period, thus permitting them to initiate assessment proceeding on such sales. The effect was to confirm the *United Motors* rule for the period, 1st day of April, 1951 to the 6th day of September, 1955 and this was recognised in *Sundararamier & Co.*, v. *State of Andhra.*[11]

---

8. See *Sundararamier & Co.* v. *State of Andhra Pradesh*, (1958) 9 S.T.C. 298: A.I.R. 1958 S.C. 468, 485: (1958) S.C.R. 1422.
9. The Act reads: "Notwithstanding any judgment. . . of any Court, no law of a State imposing or authorising the imposition of, a tax on the sale or purchase of any goods where such sale or purchase took place in the course of interstate trade or commerce during the period between 1st day of April, 1951 and 6th day of September, 1955, shall be deemed to be invalid or ever to have been invalid merely by reason of the fact that such sale or purchase took place in the course of interstate trade or commerce; and all such taxes levied or collected or purporting to have been levied or collected during the aforesaid period shall be deemed always to have been validly levied or collected in accordance with law".
10. See foot note 5, *supra*, for Art. 286 (2).
11. Supra, foot note 8. The Supreme Court held that by virtue of the Act the importing state could validly tax an interstate transaction in which the goods had been delivered for the purpose of con-

Another difficulty that arose after the *Bengal Immunity* case was the privileged position that the interstate buyer was accorded by enabling him to make his purchases interstate free of sales-tax. That might divert trade into artificial channels and thus lead to economic waste.

Further, the decision adversely affected the financial resources of the states. They were badly in need of money and agitated for some alternative arrangement to offset the loss occasioned by the decision.

The matter was considered by the Taxation Enquiry Commission which made its recommendation in Vol. III of its report published in 1953-54. Mainly on its recommendations, the Constitution was amended by the Sixth Amendment Act of 1956 and the Central Sales-Tax Act was enacted in 1956 by Parliament.

II

The Constitution (Sixth Amendment) Act has given power to Parliament (i) to impose taxes on sale or purchase of goods in the course of interstate commerce (Entry 92-A, List I of VII Schedule);[12] (ii) to formulate principles for determining when a sale or purchase takes place outside the State or in the course of import of goods into, or export of

---

sumption therein even though in interpreting the identical constitutional provisions earlier in the *Bengal Immunity* case it had held otherwise. Commenting on the decision Prof. William G. Rice very aptly points out: "I know of no American case that has taken the bold step of deciding that language directly borrowed by state legislation from the national constitution has a different meaning in that legislation than it had in the Constitution. Yet, in the case of *Sundararamier* this is the statesmanly decision of the Indian Supreme Court regarding the Explanation paragraph of Art. 286". *Division of Power to Control Commerce between Centre and States in India and in the U.S.A.*, 1, J.I.L.I. (1958) pp. 166-7.

12. Entry 92-A reads: "Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade and commerce". Previously, Parliament did not possess power to impose sales tax on interstate transactions, though it could have given power to the states to levy tax on such transactions.

the goods out of, the territory of India [Art. 286(2)]; (iii) to put "such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify" on state tax laws with regard to goods declared by Parliament to be of special importance in interstate trade or commerce [Art. 286(3)].[13]

(i) The Taxation Enquiry Commission did not recommend complete exemption of interstate transactions from sales tax. It recommended that interstate sales tax should be the concern of the Union which would charge a tax at a reasonable rate in the interest of the country as a whole. The exporting state should levy this tax on the authorisation and as an agent of the Union.[14] The Union and not the states had to be given power to tax interstate transactions because it was essential that on such transactions a reasonable rate of tax in the interest of the country as a whole should be imposed which could hardly be ensured if the power were given to the states; and further that the tax should be assessed and collected at a place where the seller was situated, i.e. in the exporting state, in order that the non-resident dealers were not subjected to the difficulties mentioned earlier. It is true that under clause (2) of the old Art. 286 Parliament could have given power to the states to impose tax on interstate sale or purchase but this applied to the importing states and the exporting states could not have

---

13. Art. 286 as it stands at present, after its amendment by the Constitution (Sixth Amendment) Act, 1956, reads:
    (1) No law of a State shall impose or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place—(a) outside the State; or (b) in the course of import of the goods into, or export of the goods out of, the territory of India.
    (2) Parliament may, by law, formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1).
    (3) Any law of a State shall, in so far as it imposes, or authorises the imposition of, a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in interstate trade or commerce, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament, may, by law, specify.
14. *Report of the Commission, Vol III*, pp. 45-62.

taxed even with parliamentary consent because of the prohibition of clause (1) of Art. 286, and the provisions of clause (2) could not be projected into clause (1).[15]

(ii) Prior to the Constitution (Sixth Amendment) Act, 1956 the Explanation to Art. 286(1) had defined an outside sale. Parliament has now been given power to define an outside sale. so that the definition could be amended easily instead of having recourse to a tedious and rigid process of amending the Constitution in case of difficulty.

(iii) Previously Cl. (3) of Art. 286 provided that no state, without the assent of the President, should impose sales tax on commodities declared by Parliament to be essential in the life of the community. This, therefore, enabled Parliament[16] to intervene in the internal system of a particular state, even though a commodity might not be essential from the point of view of the consumers of the other states. The matter of taxation of a commodity essential to the life of the community in a state could be appropriately left to that state since it is that particular state which would feel the impact of the needs of its people. In this regard, the Taxation Enquiry Commission observed: "On the other hand, the restrictions rest upon a concept of 'essentiality' which makes no distinction between the 'community' as represented by the people of the particular State and the community as represented by the nation as a whole. In regard to the impact of the sales tax of a particular State on the people of that State, it seems to us unnecessary that the Central Government should exercise through Parliamentary legislation a jurisdiction which, in terms of the State's own powers, is at once concurrent and over-riding. . . It is they (States) who will feel the impact of the discontented dealer and consumer. . . ."[17]

However, the Commission, in order to keep the incidence of tax on out-of-state consumers within limits, recommended central control over intrastate sales taxes on certain

15. *Cf. Ram Narain Sons Ltd.* v. *Asstt. Commissioner of Sales Tax*, AIR. 1955 S.C. 765.

16. In pursuance of Cl. (3) Art. 286, Parliament enacted the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, 1952 (Act 52 of 1952), declaring certain goods to be essential to the life of the community.

17. *Report of the Commission, Vol. III*, p. 51.

raw materials of special importance from the point of view of volume of interstate trade and consumers or of industry in terms of the country as a whole. The Commission pointed out that by taxing various raw materials while they were still in intrastate commerce "the State Government can effect an increase in the cost of manufactured article whether such manufacture takes place in the State which produces the raw material or in another which imports the material from that State; in either case, to the extent that the finished goods are consumed in a State other than the one which taxes the raw material, the increase in cost on account of tax is a matter of direct concern to the consumer of another State. This, therefore, is an example of an intrastate sales-tax having an important interstate bearing which makes it an appropriate item for control by the Union".[18]

Why should a state impose an unjust rate of tax on raw materials produced in that state? A state may be led to impose an unduly high rate of tax on a commodity either when it is not consumed at all within the state,[19] or if it feels that the burden which is falling on its consumers will be more than offset by the gain in revenue ultimately derived from outside consumers. In that situation, the national policy of keeping the price level low for the consumers in terms of the country as a whole may require central control over intrastate sale of such a commodity. A word of caution must be said here. In order that there may not be too much interference with the state sales tax laws by the Centre, it is essential that the category of such commodiates must be kept to a minimum. There is an implicit built-in check on any state tendency to impose a very high rate of tax on a commodity—firstly, the political restraint of its consumers and the pressure of business groups; secondly, competition with out-of-state products.

There is also the question whether if taxation of in-

---

18. *Ibid*, p. 55.
19. Then, to use the language of Mr. Justice Stone of the U.S. Supreme Court, "to the extent that the burden falls on economic interests without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the States". *Mc-Goldrick* v. *Berwind White Coal Mining Co.*, 309 U.S. 23, 46 (1940).

trastate sale of certain commodities is to be controlled by the Union, other local taxes from mine to mill, from field to factory should not also be controlled; for they may fall, equally with sales taxes, on out-of-state consumers. The answer to this is that the scheme of the distribution of other taxing powers between the Union and the states is such that by such taxation no state will be able to increase the cost of production of an article to an appreciable extent. Important powers of taxation like income tax and excise duties (except excise on alcohols) belong to the Union. The states possess power to tax mineral rights but this power is subject to any limitations imposed by Parliament by law relating to mineral development.

The other relevant powers of taxation which belong to the states are: (1) taxes on professions, trades, callings and employment, and (2) taxes on lands and buildings. However, Art. 276 of the Constitution puts an upper limit of Rs. 250/- to taxes in the first category. As regards property taxes, they are a negligible item in the total cost of an industrial product. Further, while selection of buildings devoted to a particular industry for higher taxation than others may raise questions of infringement of Art. 14 of the Constitution,[20] a general levy of tax on all buildings devoted to industries generally would provoke local complaint.

---

20. The following cases under Art. 14 of the Constitution regarding state taxes are worth nothing: *V. M. Syed Mohammed & Co.* v. *State of Andhra,* (1954) 5 S.T.C. 108: (1954) S.C.R. 1117: A.I.R. 1954 S.C. 314; *G. Butchaiah Chowdary* v. *State of Andhra,* (1958) 9 S.T.C. 104: A.I.R. (1958) A.P. 294; *Pithapuram T.T.C. & S. M. Union* v. *State,* (1958) 9 S.T.C. 723: A.I.R. (1958) A.P. 558; *Bherulal v. State,* A.I.R. (1956) Raj. 161; *Firm Jaswant Rai Jai Narain* v. *Sales Tax Officer,* (1955) 6 S.T.C. 386: A.I.R. (1958) All. 585.

It may be noted that in the *Syed Mohammed* case the appellant had challenged the imposition of tax on hides and skins on the ground that the Act had singled out one commodity and, therefore, the tax was bad. The Court negatived the contention on the ground that it was not shown that the purchasers of other commodities were similarly situated as purchasers of hides and skins. However, in case of property taxes, all buildings used for industrial purposes being alike, it may be difficult without contravening Art. 14 to single out buildings on the basis of the particular industry carried on in them.