

CHAPTER I

WHAT IS AN INTERSTATE TRADE BARRIER?

Economic unity of India demands that no discriminatory impediments be put on the free flow of commerce between the states. To put a curb on these impediments the Indian Constitution has incorporated Part XIII and has by Art. 286,¹ imposed limitations upon the state sales tax affecting interstate commerce.

Part XIII opens with Art. 301 which states: "Subject to the other provisions of this Part, trade, commerce and intercourse throughout the territory of India shall be free". Since no freedom can be absolute Art. 301 is followed by other articles laying down the extent to which freedom of interstate trade and commerce could be restricted.

Thus Art. 302 gives power to Parliament to restrict freedom of trade and commerce "as may be required in the public interest."

Article 303 prohibits Parliament and the state legislatures from making any law which gives any preference to one state over another or discriminates between the states by "virtue of any entry relating to trade and commerce in any of the lists of the Seventh Schedule." However, Clause (2) of the Article permits Parliament to do so if it declares that it is necessary for the purpose of dealing with a situation arising from scarcity of goods in any part of the territory of India.

Article 304 softens the rigours of Art. 301 so far as the states are concerned. It has two clauses. Clause (a) permits an importing state to levy on imported goods the same taxes as are levied on local goods. Clause (b) allows the states, with the previous sanction of the President, to impose such reasonable restrictions on the freedom of trade or commerce as may be required in the public interest.

Article 305 saves existing laws from the operation of Articles 301 and 303.

1. See *infra* Ch. II, f.n. 13 at p. 14 for Art. 286.

Article 307 authorises Parliament to establish an authority for carrying out the purposes of Arts. 301 to 304.

The power to levy sales tax by the states² is subject to the foregoing provisions. Thus the states cannot impose discriminatory taxes upon imported goods because of the specific limitation in Art. 304(a)³. So also no state may discriminate or give preference to one state over another in imposing taxes on goods going out of the state, either because of the specific limitation in Art. 303⁴ or by reason of the fact that such taxes may amount to unreasonable restrictions on trade and commerce under Art. 304(b).

It is not yet beyond doubt whether presidential assent is necessary for the validity of state tax laws under Art. 304(b). Till recently there has been a controversy⁵ whether Arts. 301 and 304(b) cover state tax laws or not. In *Atiabari Tea Co. Ltd. v. State of Assam*,⁶ the majority⁷ of the Supreme Court has held that all taxes which directly and immediately restrict freedom of trade and commerce come within the coverage of Art. 301 and, therefore, a state Act imposing such a tax must

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2. States in India derive power to levy sales tax from Entry 54, List II of the Seventh Schedule to the Constitution which reads: "Taxes on the sale or purchase of goods other than newspapers."
 3. See *Mohammad Siddiq v. State of M.B.*, A.I.R. 1956 M.B. 214. Also, *Bharat Automobiles v. State of Assam*, (1957) 8 S.T.C. 537: A.I.R. 1957 Assam 1; *Umraolal Subalal v. State of M.P.*, (1960) 11 S.T.C. 337.
 4. See *infra*, Chap. V, f.n. 6.
 5. For cases which held that state tax laws came within the purview of Art. 301, see *Automobile Transport (Raj.) v Rajasthan*, A.I.R. 1958 Raj. 114 and *Bombay v. Chamarbaugwali*, A.I.R. 1956 Bom. 1. For cases contra., see *H. P. Barua v. State of Assam*, A.I.R. 1955 Assam 249; *M. K. Parmeswaran v. Sub-Magistrate*, A.I.R. 1958 Kerala 52; and *Atma Ram Budhia v. State of Bihar*, A.I.R. 1952 Pat. 359.
Also refer to the following articles: Rice, *Division of Power To Control Commerce Between Centre and States in India and in the United States*, 1. J.I.L.I. 151; Derham, *Some Constitutional Problems Arising Under Part XIII of the Indian Constitution*, *Ibid* p. 523.
 6. A.I.R. 1961 S.C. 232.
 7. Gajendragadkar, Wanchoo, and Das Gupta, JJ. Shah, J., concurred in the majority opinion, and Sinha, C. J., dissented.

satisfy the requirements of Art. 304(b) as to reasonableness, public interest and presidential assent. In this case a tax on carriage of tea by inland waterways or road was held to be a direct restriction on trade and commerce, and, therefore, invalid in view of the lack of presidential assent. Whether sales tax also operates directly on trade and commerce was not considered in the case. There is no doubt that sales tax directly and immediately restricts trade and commerce⁸ and it is likely that the courts will take the same view following the *Atiabari* case. Therefore, an act of state legislature in order to be valid must obtain the previous⁹ assent of the President¹⁰ before its introduction in the state legislature. The requirement of presidential assent imposes a check on regional economic pressures by subjecting them to examination in the light of the interest of the national economy.¹¹

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8. Thus Prof. Derham states: "Now a sales tax is a tax upon goods which operates by choosing the act of sale as the criterion for attracting liability to pay the tax. It is therefore a direct burden or restriction on trade and commerce—'sale' being a central part of the concept," *supra*, f.n. 5, p. 550.
 9. If the previous sanction of the President is not obtained that infirmity may be cured by the subsequent assent under Art. 255, see *Atiabari* case, *supra*, f.n. 6, p. 253.
 10. Some of the state sales tax statutes which have received presidential assent are of Andhra Pradesh, Bihar, Madhya Pradesh, Mysore, Rajasthan and U.P. This assent however has not been obtained under Art. 304(b) but under Art. 254(2) which provides that "Where a law made by the Legislature of a State with respect to one of the matters enumerated in the Concurrent List contains any provision repugnant to the provisions of an earlier law made by Parliament or an existing law with respect to that matter" then it will be essential to have presidential assent. It has been suggested that some of the provisions of state sales tax statutes are repugnant to the Sale of Goods Act, Criminal Procedure Code and the Indian Evidence Act. It is a matter worth examining (but not at this place) whether there is really any repugnancy. In *State of Madras v. Gannon Dunkerley & Co.*, (1958) 9 S.T.C. 353, 381: A.I.R. 1958 S.C. 560, the Supreme Court held that there was no question of repugnancy between the Sale of Goods Act and the sales tax statute of a state, since the two dealt with different things, though the court held on different considerations that sale in a state sales tax statute should mean the same thing as in the Sale of Goods Act.
 11. See *Atiabari* case, *supra*, f.n. 6, p. 252.

The limitation contained in Art. 286(1)(a) restricts a state from imposing taxes on sales taking place outside the state to avoid multiple taxation of the same transaction by different states.¹² By cl. (2) of the same Article, Parliament has been given power to define an outside sale.

Entry 92-A, List I of the Seventh Schedule gives power to Parliament to levy "taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of interstate trade or commerce." By virtue of Art. 246(1),¹³ states are prohibited to levy sales tax on interstate sale or purchase transactions.

The Parliament's power to levy interstate sales tax is also subject to the limitations set out in Art. 301 and Art. 303.¹⁴ However, Art. 302 empowers Parliament to restrict interstate and intrastate trade and commerce if public interest requires the same, subject to Art. 303 that no preference be given to one state over another or discrimination be made between states.

The Constitution thus prohibits multiple taxation of interstate sale transactions, discrimination between states in imposing taxes on these transactions, and discriminatory taxes on goods imported into and exported out of a state. It does not contemplate immunity from taxation of such transactions or goods. No doubt, the flow of interstate commerce would be at its maximum if such commerce were immune from taxation. But does the economic unity of India demand that no tax should be levied on interstate commerce? Just as discriminatory taxes may be bad, it is also not in the best economic interests of the country to completely free interstate commerce from taxation. If no taxes are levied on interstate commerce, the result would be that consumers could get out-of-state goods more cheaply than local goods, and local dealers would suffer competitive disadvantage compared with outside dealers. It is one thing to avoid impeding interstate com-

12. See *infra*, Chap. II.

13. It reads: "Notwithstanding anything in Clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule (in this Constitution referred to as the "Union List")."

14. See *infra*, Chap. V, f.n. 6.

merce by imposing discriminatory burdens upon it which internal trade does not have to bear, but quite another to place local products and local business at a disadvantage in competition with outside goods and dealers.¹⁵ It follows that immunity of interstate commerce will create artificial channels of trade by putting local business at a disadvantage and economic waste in transportation by encouraging persons to make their purchases out of state tax free.¹⁶

Thus, non-discriminatory taxes on interstate commerce do not create interstate trade barriers. The essential test of

15. See *State of Bombay v. United Motors*, (1953) 4 S.T.C. 133, 150: (1953) S.C.R. 1069: A.I.R. 1953 S.C. 252.

16. It may be noted that even in the United States it has been recognised that interstate commerce must pay its way and is subject to state taxation though the extent and limit of the state power are by no means clear. In *Western Live Stock Co. v. Bureau of Internal Revenue*, 303 U.S. 250, 254 (1938), Mr. Justice Stone of the United States Supreme Court stated: "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business. 'Even interstate business must pay its way', *Postal Telegraph Cable Co. v. Richmond*, 249 U.S. 252, 259; *Ficklen v. Taxing Dist.*, 145 U.S. 1, 24 . . . and the bare fact that one is carrying on interstate commerce does not relieve him from many forms of taxation which add to the cost of his business." Cf. *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327, 330 (1944) ("The very purpose of the commerce clause was to create an area of free trade among the several states."): *Joseph v. Carter & Weeks Co.*, 330 U.S. 422, 428 (1947).

Argument is heard in the United States also to the effect that the Supreme Court should uphold all non-discriminatory states taxes. It is stated: "Why should a tax upon the sale of the goods be forbidden when the goods are ordered across state lines prior to shipment when a similar tax with the same economic effects upon the flow of commerce is sustained if the goods enter the state before the sale is made, or if the tax is imposed upon the storage or use of the goods immediately after they enter the state?" Further ". . . the idea of commerce flowing freely back and forth across the map of the United States is an attractive one. This flow would be the greatest, of course, if such commerce were entirely freed from state taxation but a premium upon interstate shipment of goods to market could result in as uneconomical a system of distribution as could a penalty." Barrett, Jr., "*Substance*" v. "*Form*" of Commerce Clause, 101 U. of Pa. L. Rev. 740, 756 and 760 (1953).

a trade barrier is favouritism or inequality of burden and not "regulation" or "taxation." Some of the ways in which interstate trade barriers by taxation could arise may be as follows:

An interstate trade barrier may arise when a state discriminates against imported commodities in intrastate commerce by imposing higher taxes on them than locally produced goods.¹⁷ It is possible, conversely, that the favoured position of interstate trade may operate to the unjustified disadvantage of intrastate trade.

It may arise when the state of origin discriminates against a commodity going out of the state by imposing higher taxes on it than when it is locally consumed.¹⁸

Heavier burden on interstate commerce may be created by the cumulative effects of the sales tax laws of different states and the Centre, even without an intent to discriminate against interstate commerce. The problem of multiple taxation of the same interstate sale transaction by different states has been solved by Art. 286. However a commodity figuring in interstate commerce may still be subject to multiple taxation by the exporting state in its prior intrastate sale, by the Union in interstate sale, and by the importing state in a subsequent intrastate sale.

The diversity of sales tax laws may also create discrimination against interstate commerce. Thus, interstate purchases of raw materials by a manufacturer are subject to the Central Sales Tax Act but such purchases within a state may be exempt from local taxes.

When a non-resident dealer experiences administrative difficulties in complying with the law of a taxing state, obstacles to interstate trade may also arise.¹⁹ Sometimes these administrative difficulties might themselves be a greater burden than the tax itself.

If an outwardly non-discriminatory tax is imposed by an importing state on resale of articles which are produced outside and not within the taxing state, a burden on impor-

17. See cases cited in f.n. 3, *supra*.

18. See *Bherulal v. State of Rajasthan*, A.I.R. 1956 Raj. 161.

19. See *infra*, Chap. II.

tation for resale is imposed. Such a tax must be borne chiefly by consumers of the imported commodities and is likely to check importation, especially if an untaxed substitute is produced within the taxing state.²⁰

20. See *infra*, Chap. VI.