WORKING PAPER

PROJECT : Inter-State Movement of Commodities and Persons.

TOPIC : Inter-State Trade Barriers created by Sales-Tax in India.

PRELIMINARY EXPLANATION

WHEN the decision to take up this project was made at the 1957 Seminar of the Indian Law Institute (held from 14th December to 21st December, 1957), it was noted that concrete examples of barriers to the free flow of inter-State commerce and State residential preferences have begun to emerge into public view in India since the adoption of the Constitution. A major problem inherent in all the federal systems is the tendency of the individual State Governments to favour local interests in preference to out-of-state interests, thus hindering the development of a national economy and economic homogeneity of India. Therefore, a study into the problem was thought to have become essential in order to determine whether in India this tendency has been growing to a serious extent.

PLAN OF WORK

At the initial stage for convenience of study it was decided to divide the project into (a) taxation, and (b) other regulations. After a preliminary study taxation was further divided into (a) Sales-Tax, and (b) other taxes. The sub-project on "regulations" was divided into (a) motor carriers; (b) commodities under the Essential Supplies Act; and (c) other commodities.

OUTLINE OF SCOPE AND NATURE OF WORK DONE

It was at the outset realized that a proper inquiry into the whole subject required the co-operation of various groups (economists, lawyers, traders, industrialists, etc.) and associations (chambers of commerce, merchants' associations, bar councils, law faculties, transport authorities, banks, etc.). Therefore, a questionnaire has been prepared for that purpose. Already about 700 copies of the questionnaire have been sent out and the replies to those are still awaited.

On the topic of sales-taxes, all the State sales-tax laws and the Central Sales-Tax Act have been examined and analysed. Sales-tax Rules of all the States till 1953 and up-to-date Rules for Madras have also been examined. About 60 judicial decisions have been studied and consulted. Material of a general nature was also studied. With the help of all this material, a tentative report has now been prepared, and is available for examination. The conclusions are summarised below.

PRELIMINARY CONCLUSIONS

(1) The decision in State of Bombay *v.* United Motors (A.I.R. 1953 S.C. 252) in 1953 created considerable difficulty for the business community, because that decision declared that importing States had power to tax out-of-State dealers on their inter-State sales provided the goods were sent to those States for the purpose of consumption therein.

(2) The case of Bengal Immunity Co. *v.* State of Bihar (A.I.R. 1955 S.C. 661) by holding that such inter-State sales, in the absence of Parliamentary approval, were immune from taxation, put an end to this situation, but brought in its wake many new problems. These problems were mainly two : (1) those arising from the loss of an important source of revenue to the States at a time when they badly needed funds; and (ii) those arising from the privileged position that inter-State purchaser was accorded particularly if there was no further intra-State sale subject to taxation.

(3) To meet the situation, the Taxation Enquiry Commission in its report in 1953-54 recommended that Art. 286 should be amended so as to give exclusive power to the Parliament to tax inter-State sales transactions. It also recommended the enactment of the Central Sales-tax Act by the Parliament. Both these recommendations were implemented by amendment of the Constitution and the enactment of the Central Sales-Tax Act in 1956.

It may be noted that the only solution to the problem of taxation of the out-of-State dealers that the Taxation Enquiry Commission could visualise was to vest the exporting States with power to tax the sale or purchase in inter-State commerce. Under clause (2) of Art. 286 Parliament could have given power to the States to impose tax on inter-State sale or purchase. But this applied only to the importing States and the exporting States could not have taxed even with the Parliamentary consent because of the prohibition of clause (1) of Art. 286. Compare Ram Narain Sons Ltd. *v.* Asstt. Commissioner of Sales-Tax, (A.I.R. 1955 S.C. 765).

(4) The Central Sales-Tax Act by section 9 has given power to the exporting State to collect the tax on inter-State sales on behalf of the Centre but to appropriate the tax for its (exporting State) own use. As generally the exporting State will be the place where the dealer carries on the business of buying or selling, it has, by and large, done away with the problem of taxation of the out-of-State dealers by the importing State. But, still in quite a few cases this problem remains even under the Central Act, e.g, when the goods are supplied from a State in which the dealer himself does not carry on the business of buying or selling. This presents the question whether the burden so imposed is serious enough to warrant further amendment of the Act.

(5) On non-declared goods, the Central Act has prescribed a tax of one per cent, on inter-State sales made by a dealer to a registered dealer[1], and seven per cent. or the rate prevalent in the exporting State, which-

1. A registered dealer, as distinguished from the unregistered, is one who, according to the law of the State, has the minimum turn-over required before liability to pay the sales-tax arises.

ever is higher, on inter-State sales made by the dealer to a non-registered dealer (section 8). Originally the rate of tax on such transactions was the rate which would have been applicable had the transaction taken place inside the exporting State. The only substantial reason advanced by the Government for changing the rule to the present one seems to be that the rate of seven per cent. would provide some sort of uniformity or standardization. (Parliamentary Debates, Rajya Sabha, Official Report, Sept. 8, 1958, pp. 183-184). However, the rate of tax on various commodities usually varies from 3 to 5 per cent. in different States. The higher rate of seven per cent. will either lead to the dimunition of inter-State trade by discouraging the unregistered dealers or consumers from making their purchases outside their own State, or lead to all sorts of evasion devices, as for example, taking delivery of the goods in the exporting State. Therefore, it is desirable to re-consider restoration of the original provisions.

(6) The Central Act makes provisions for controlling intra-State taxation of certain sales which have an important bearing on inter-State commerce. The Act has declared certain raw materials as "declared goods which have special importance for inter-State commerce, and prohibits the States from charging a tax of more than 2 per cent. and at more than one stage on intra-State sale or purchase of such commodities. (Section 15). The result of the various provisions in the Act (Sections 15 and 8) is that there will be a maximum of 2 per cent. tax at all stages when the sale or purchase takes place solely inside the State and maximum of 3 per cent. at all stages on inter-State transaction when the inter-State buyer is a registered dealer and is purchasing for re-sale. Consequently, a registered buyer purchasing in inter-State commerce for re-sale would be at a disadvantage as compared to an intra-State purchaser.

State Sales-tax Laws.

(7) (*i*) The Constitution coupled with the Central Sales-Tax Act has solved the problem of taxation of the same transaction by more than one State and to a large extent, the problem of taxation of out-of-State dealers. However, the State sales-tax laws can create other forms of discriminations against inter-State commerce. Such barriers as have been revealed from examination of the sales-tax laws of the States are as follows:

(*a*) One obvious way to discriminate against extra-State products will be to charge a lower tax on, or to totally exempt from tax, commodities produced within the State. Two striking examples are : *Kalabattu* and locks and their parts manufactured in U.P. when sold by the manufacturers thereof in U.P. (Notification No. ST-911 IX dated 31st March, 1956), and locally manufactured gold and silver gola, salma sitara and badla in Rajasthan (Rajasthan Sales-Tax Act, Notification No. F. 21(7) S.R./55 dated 14th April, 1955, Entry 20), are exempt from taxation.

(*b*) Quite a few States provide an exemption from sales-tax for goods processed within the State out of raw material produced there. The conspicuous example is that of hides and skins in the State of Madras, (Rule 16 of the Madras General Sales-

Tax, Turn-over and Assessment Rules), Andhra Pradesh and Mysore.

(*c*) Some States make provisions for the exemption from sales-tax of commission agents or brokers who buy or sell on behalf of known principals *within* the State provided certain conditions are fulfilled. Commission agents or brokers who sell on behalf of principals outside the State are not so exempt. This distinction may be justified on the ground that principals within the State are themselves subject to tax whereas those outside are not. Examples are Madras (Section 8 of the Madras General Sales-Tax Act), Andhra Pradesh, Kerala, Mysore and Rajasthan.

(*d*) Some States provide a minimum turn-over for dealers before their liability under the Sale-Tax Act accrues, but the agents of non-resident dealers are taxed irrespective of the turn-over, e.g., Andhra Pradesh (Section 5 of the A.P. Sales-Tax Act) and Mysore.

(*e*) Many States provide a lower turn-over limit for importers than manufacturers and other dealers before liability to pay sales-tax is incurred, as for example, Punjab (Section 4 of the Punjab Sales-Tax Act), Madhya Pradesh and Rajasthan. Delhi, Bombay and West Bengal have a lower limit for importers and manufacturers than other dealers.

(*ii*) The Courts have not yet had an occasion to decide on the validity of the provisions mentioned above. Art. 304 (a) of the Constitution prohibits discrimination against goods imported from other States. Of course if and when any such case arises its constitutional validity will be examined by Courts. Compare Bharat Automobiles *v.* State of Assam (A.I.R. 1957 Assam 1).

COMMENTS.

Both Art. 286 of the Constitution and the Central Sales-tax Act together have solved the problem of multiple taxation of inter-State sales and, by and large, the problem of taxation of out-of-State dealers by the importing States. But the problem of other forms of discriminations existing in the taxing laws of the States still remains (though fortunately, as seen above, the number of such barriers is not large at present).

However, the present study does not attempt to find out the administrative barriers, i.e. barriers arising out of the discriminatory and burdensome administration of an innocent looking statute, which might exist in the country. The number of such barriers may be large in a federal country. Such barriers can only be found from the affected persons. It is expected that the replies to the Institute questionnaire will enable us to know of their existence. Further, it would not be proper to assert confidently that the various provisions in the State laws which appear on their face to create inter-State barriers really in fact do so. It is a very difficult matter to find out when such barriers are in fact created. Where the calculations of relevant economic factors can easily

be made, it may be possible to do so. But usually it is not easy to examine the economic factors of a complicated nature involved in such cases. Here again contact with the business and the trading community through the questionnaire and interviews may help in finding out to what extent the State statutes actually create trade barriers, because to use a hackneyed phrase, they only know where the shoe pinches. Irrespective of constitutional questions, such further information may help in developing legislative tax policies which will not seriously impede inter-State commerce.

From the constitutional angle, when a statutory provision looks discriminatory on the face of it, the practical question is, should the judiciary pierce the veil of formal discrimination and examine the complicated tax structure of the various States? In this respect the following observations of the United States Supreme Court in *Freeman* v. *Hewit*, 329 U.S. 249, 256 (1946) are relevant: "The immunities implicit in the Commerce Clause and the potential taxing power of a state can hardly be made to depend in the world of practical affairs, on the shifting incidence of the varying tax laws of the various states at a particular moment. Courts are not possessed of instruments of determination so delicate as to enable them to weigh the various economic factors in a complicated economic setting. . . ."

One point which has not been touched in the paper—being beyond its scope—but which deserves attention is the need for uniformity in the sales-tax laws of the States. The lack of uniformity "creates unnecessary complications and hardships particularly in regard to inter-State transactions and dealers who have branches in more than one State." Taxation Enquiry Commission Report, 1953-54, Vol. III, pp. 75-76.

FURTHER RESEARCH

Further research on this particular topic will be suspended pending receipt of full response to the questionnaire and further general discussion with the Advisory Committee and the general constituency of the Institute. Thereafter it is hoped to revise the Main Paper, out of which this Working Paper has been prepared, for publication. Meanwhile, primary attention will be devoted to inter-State barriers arising from State regulation of motor transport.