CHAPTER VI
TAXING POWERS

GENERAL CONSIDERATION

6.1 The taxing powers have been divided between the Union and the States in accordance with entries in Lists I and II of the Seventh Schedule. Thus entries 82 to 92A of the List I mention the taxes that may be imposed by the Union, and entries 45 to 63 of List II specify the taxes that may be imposed by the States. It is significant that no taxing powers have been mentioned in the Concurrent List. Hence theoretically, the taxing power of the Union and of the States being in the exclusive fields, there cannot be any conflict between them. However, as noticed earlier, conflicts might occur because of the overlapping of the fields or because the legislation in any particular case might appear to relate to entries in the different lists. In the first case the conflict may be resolved by the proper definition of the fields and, in the second case, by the application of the doctrine of characterisation or pith and substance.

6.2 Certain broad features of the taxing powers may be noticed before conflicts of the type mentioned above with respect to the actual entries are examined. Taxation is defined in article 366(28) to include the imposition of any tax or impost whether general or local or special. It has already been noticed that this broad definition is capable of including

1. Para 3.51 ante.
within its ambit any impost including a fee. However, the power to impose fees with reference to entries in the lists has been separately conferred in all the three Lists. Hence for the purpose of the present discussion fees with respect to matters in List ¹² and fees with respect to matters in List ¹³ might also be included. But the distinction between tax and fee, and the possibility of levying a tax in the guise of a fee have already been considered under the heading of colourable legislation and, therefore, it is proposed to deal in this chapter only with the conflicts of the taxing powers proper.

6.3 As has already been stated, a specifically enumerated power cannot be treated as incidental power and, since the taxing powers have been specifically mentioned in the entries, a general legislative entry will not be held to include the power to impose a tax with respect to that entry. So the power to legislate with respect to land under entry 18 of List II does not include a power to levy tax on land because it is separately provided for in entries 45 and 49 of List II. The power to legislate on betting and gambling under entry 34 of List II does not include, as seen earlier, the power to levy a tax on betting and gambling specifically mentioned in entry ⁶ 62 of List II.

2. Entry 96 of List I.
3. Entry 66 of List II.
4. See para 2.19 ante.
5. Ibid.
6.4 As specifically stated in entry 97 of List I read with article 248 of the Constitution, the residuary power covers also residuary taxing powers. The scope of the residuary taxing powers for sustaining parliamentary legislation in respect of taxes not specifically enumerated in the Lists and sometimes for validating ultra vires taxes earlier imposed by the State legislatures will be noticed while discussing the scope of residuary powers.

SALES TAX AND OTHER TAXES

6.5 By entry 54 of the State List, the States have power to impose taxes on the sale or purchase of goods other than newspapers subject to the provisions of entry 92-A of List I. By entries 92 and 92A of the Union List, the Parliament has power to impose taxes on the sale or purchase of newspapers and on advertisements published therein, and on goods other than newspapers where such sale or purchase takes place in the course of inter-State trade and commerce, respectively. This division of the power to levy sales tax has given rise to some very nice problems in conflict. In addition, entry 84 of the Union List which authorises the imposition by the Parliament of excise duties on goods has also been alleged to conflict with the power of the State to levy sales tax. Before dealing with these conflicts, a problem common to both the types may be referred to.

Meaning of sale

6.6 The question of levying a sales tax would arise only if there is a sale as understood by the law. Entry 48 in
List II Schedule Seven of the Government of India Act 1935, and entry 54 of List II, Schedule Seven of the Constitution speak of "sale of goods". Under section 4 of the Sale of Goods Act 1930 a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. A contract of sale of goods would therefore contain four essential elements, namely, competent parties, mutual assent, transfer of property, and price. If one or more of these elements are not present it would be difficult to categorise the transaction as sale. It would not be competent for a State legislature to treat what in fact is not a sale of goods as a sale of goods and to tax it on that basis. Hence, as we have already seen, in a building contract, which was entire and indivisible, there was no sale of goods, and the materials used for construction could not be treated as having been sold to attract the Madras General Sales Tax Act, 1939.

6.7 Service of meals at a hotel to a visitor as part of the amenities incidental to the contract of service is not a sale. Even though the property in such food-stuffs may be said to pass from the hotelier to the consumer, there is no

7. Para 2.11 ante.
intention of sale and purchase. The transaction of service is one and indivisible and is not capable of being split into one for residence and one for meals.

6.8 Since the sale is a contract, if the freedom of contract is limited to a vanishing point, there is no sale. Thus when a sugar factory in Bihar sent sugar to Madras in obedience to statutory orders from the Controller of Sugar, and there was no offer to purchase from Madras, the freedom of contract was not there and the transaction would not be characterised as a sale. However, when the Iron and Steel Controller directed the delivery of goods with reference to a fixed base price and there was scope for contractual freedom to operate though in a restricted way in areas like the date of supply of the goods, and the manner of paying the price, it could not be said that the transaction was not a sale. But if the ingredients of a sale are present the fact that profit-motive is not present is irrelevant. Thus a co-operative society supplying refreshments to its members fulfils the definition of sale though profit-motive is absent.

6.9 A power to levy sales tax does not extend to the levy as tax of amounts not leviable as such under the law. Hence a provision in a State Sales Tax Act, according to which amounts collected as tax on transactions not liable to tax under the Act, should be paid to the government, unless refunded, was struck down as ultra vires entry 54 of List II.

6.10 An agreement of hire purchase with option to purchase the goods hired contains not only a contract of bailment, but also an element of sale. This sale element is sufficient to sustain a sales tax.

6.11 If the transaction is a sale, and the power of the State to levy a tax on sale is established, then the question of such power conflicting with certain powers given to the Union may arise for consideration.

Sales tax and excise duties

6.12 The power of the States to levy sales tax may seem to conflict with the power of the Union to impose excise duties. As we have seen while dealing with the question of reconciliation of overlapping entries the cases decided under the Government of India Act, 1935 by the Federal Court and the

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16. See paras 2.12 and 2.13 ante.

Privy Council had, by applying the principle of harmonious construction, restricted the power of the Federal Legislature to impose duties of excise at the stage of production or manufacture, and of the Provincial Legislatures, to impose a sales tax on the sales thereafter. These decisions have been approved by the Supreme Court as correctly laying down the characteristics of an excise duty.

Thus by a process of reconciliation of the entries applying a well-known technique of interpretation, the apparent conflict between the power to levy sales tax on the one hand, and excise duties on the other, has been solved.

Intra-State sales tax and inter-State sales tax

6.13 It has been noticed that the power of levying a tax on sale or purchase in the course of inter-State trade and commerce belongs by entry 92A of the Union List to the Union Parliament. Therefore the power to levy a sales tax on intra-State sales belongs to the States. This is however, subject to certain limitations. A State cannot tax "an outside sale" and a sale or purchase in the course of import or export. In the case of goods declared by parliamentary law to be goods of special importance in inter-State trade and commerce, State taxation is further subject to the conditions prescribed by Parliament.

The nexus theory and the prevention of multiple taxation

6.14 Though the legislative power of a State is territorially limited to that State or part thereof when it comes to the question of taxing powers, a State gets competence on the basis of the doctrine of territorial nexus to tax events that have not taken place fully within its territorial limits. It is enough even if the territorial connection is partial if it is real and not illusory and the taxing liability is relevant to that connection.

6.15 It has already been stated that a sale of goods consists of various ingredients like goods, agreement to sell, payment of price and delivery of goods. On the basis of the doctrine of territorial nexus, a State would be competent to levy a sales tax based on one or more of the above elements. After sales tax was introduced in the Provinces under the powers conferred by the Government of India Act 1935, it became the fashion for many Provinces to levy on the basis of the territorial nexus theory, tax on sale not wholly concluded

21. Wallace Brothers & Co. Ltd. v. Commissioner of Income Tax, Bombay, A.I.R. 1948 P.C. 118. (The power of the Indian legislature to impose tax on income arising abroad to a non-resident foreign company); State of Bombay v. United Motors Limited, A.I.R. 1953 S.C. 252 (The power of the State to levy sales tax even when all the ingredients of the sale are not within the territory); State of Bombay v. R.M.D. Chemburbaugwala, A.I.R. 1957 S.C. 699 (The power of the State to tax on betting and gambling carried on from places outside the State).
within the territory of the Provinces. Thus in the case of a sale where the goods are in one Province, the owner in another, buyer in a third Province, the contract is concluded in a fourth Province, the price is paid in the fifth Province and the goods are delivered in a sixth Province all the Provinces could levy a sales tax. When the Constitution was enacted, to prevent this evil of multiple taxation it was provided that only the State in which the goods were delivered for consumption should be allowed to levy a sales tax. This was achieved by article 286(1)(a) and the Explanation thereunder (as originally enacted).

23. 286(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 inter-State 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 the imposition of such tax be 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".
6.16 A State was prevented from levying a sales tax on 'outside sales', and a sale where the goods were delivered for consumption in a State was treated as an 'inside sale' with regard to that State and 'outside sale' with regard to all other States. In the interest of protecting the freedom of inter-State trade and commerce from restraints on account of the levy of unreasonable sales tax by the States it was provided in article 286(2) that, without the permission of the Parliament by law, no State should impose a sales tax on a sale or purchase in the course of inter-State trade or commerce. In *State of Bombay v. United Motors* the majority of the Bench of the Supreme Court held in connection with the Bombay Sales Tax Act, 1952 that, when, by the Explanation under article 286(1), an inter-State sale was deemed to be an intra-State sale, a State legislature was competent to levy a sales tax without lifting the ban by Parliament as provided for in clause (2) thereof. The minority judges however held that the restriction imposed by clause (2) was an additional one, and it would not be permissible for a State to levy a sales tax on inter-State transaction only on the basis of the Explanation. In *Bengal Immunity Company v. State of Bihar* the Supreme Court overruled the above view and held that even when the fiction introduced by the Explanation converted

25. Patanjali Sastri C.J., B.K. Mukherjee, Ghulam Hasan JJ.
26. Bose and Bhagawati JJ.
an inter-State sale into an intra-State sale, without the
sanction of the Parliament as contemplated in clause (2), a
State was incompetent to levy sales tax on sale or purchase
in the course of an inter-State transaction. Thereafter taking
also into account the views of the Taxation Enquiry Commission
the Constitution was amended by the Sixth Amendment Act 1956
on 11-9-1956 substituting the new article 286 in place of the
old one. Section 4 of the Central Sales Tax Act, 1956

extracted in K. Chaturvedi, Central Sales Tax Act, (1975),
Calcutta, p.62.
29. Article 286(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.

(2) Parliament may by law formulate principles for deter­
mining 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 inter-State trade or commerce, 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.

It also introduced the new entry 92A in List I "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 or commerce". In entry 54 of List II the
State power was made subject to the provisions of 92A of
List I and clause (g) added in article 269(1) provided for
the assignment to the States of the sales taxes levied on
inter-State trade and commerce.

30. Section 4: When is a sale or purchase of goods said to take
place outside a State— (1) Subject to the provisions
contained in section 3, when a sale or purchase of goods
is determined in accordance with sub-section (2) to take
place inside a State, such sale or purchase shall be deemed
to have taken place outside all other States.

(2) A sale or purchase of goods shall be deemed to
take place inside a State if the goods are within the State—
(contd.....178).
(Act No. 74 of 1956) in force from 21-12-1956, passed in pursuance of the Constitutional amendment has provided as to when a sale or purchase of goods should be held to have taken place outside a State.

**Inter-State sales tax**

6.17 Since the power to levy a tax on inter-State sales has been transferred to the Union by the Sixth Amendment, any conflict between the power of a State to levy a tax on intra-State sale and the power of the Parliament to levy sales tax on inter-State sale can be resolved only by a proper definition of what an inter-State sale is. Article 269(3) of the Constitution, as amended by the Sixth Amendment, has empowered the Parliament to formulate the principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or commerce. Article 286(2) of the Constitution empowers Parliament to formulate the principles for determining when a sale or purchase takes place in the course

(f.n. 30 contd.)

(a) in the case of specific or ascertained goods, at the time the contract of sale is made; and

(b) in the case of unascertained or future goods, at the time of their appropriation to the contract of sale by the seller or by the buyer, whether assent of the other party is prior or subsequent to such appropriation.

**Explanation:** Where there is a single contract of sale or purchase of goods situated at more places than one, the provisions of this sub-section shall apply as if there were separate contracts in respect of the goods at each of such places.
of import of goods into, or export of goods out of, the
territory of India which are also immune from State taxation.

Sections 3 and 5 of the Central Sales Tax Act, 1956 (74 of 1956)

31. Section 3: When is a sale or purchase of goods said to take place in the course of inter-State trade or commerce— A sale or purchase of goods shall be deemed to take place in the course of inter-State trade or commerce if the sale or purchase—

(a) occasions the movement of goods from one State to
another; or

(b) is effected by a transfer of documents of title
to the goods during their movement from one State
to another.

Explanation 1: Where goods are delivered to a carrier or
other bailee for transmission, the movement of the goods
shall, for the purposes of clause (b), be deemed to commence
at the time of such delivery and terminate at the time when
delivery is taken from such carrier or bailee.

Explanation 2: Where the movement of goods commences and
terminates in the same State it shall not be deemed to be
a movement of goods from one State to another by reason
merely of the fact that in the course of such movement the
goods pass through the territory of any other State.

32. Section 5: When is a sale or purchase of goods said to take place in the course of import or export—

(1) A sale or purchase of goods shall be deemed to take place in the course of the export of the goods out of the territory of India only if the sale or purchase either occasions such export or is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India.

(2) A sale or purchase of goods shall be deemed to take place in the course of the import of the goods into the territory of India only if the sale or purchase either occasions such import or is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India.
have formulated the principles for determining when a sale takes place in the course of inter-State trade and in the course of export or import respectively. Broadly stated a sale is in the course of inter-State trade only if it occasions the inter-State movement of the goods, or if property in the goods passes in the course of the inter-State movement of the goods by the delivery of title deeds.

6.18 Since the phrases "in the course of inter-State trade and commerce" and "in the course of export or import" in sections 3 and 5 of the Central Sales Tax Act, 1956 and in the relevant sub-clauses of article 286 of the Constitution as originally enacted are analogous, the cases on the latter are considered to be helpful in understanding the meaning of the former.

6.19 The meaning of the phrase "in the course of export" in article 286(1)(b) (as originally enacted) had engaged the attention of the Supreme Court in State of Travancore-Cochin v. Bombay Company Limited. The sales involved were export sales to foreign buyers on c.i.f. or f.o.b. terms. Holding the sales to be in the course of export, Patanjali Sastri C.J. said:

"A sale by export thus involves a series of integrated activities commencing from the agreement of sale with a foreign buyer and ending with the

34. Others on the Bench were B.K. Mukherjea, S.R. Das, Bose and Ghulam Hasan JJ.
However, to avoid any possibility of conflict in this regard the Constitution itself has specified that professional tax levied for the benefit of the State, or of a local self-government unit, up to Rs. 250/- from a person should not be held to be invalid as being a tax on income. A tax on pension is not a tax on profession but on income and cannot be saved by the special provisions of article 277 if levy of the tax before the Constitution was illegal.

Tax on land and building and taxes on the capital value of assets

6.35 By entry 86 of the Union List the Parliament has the power to levy tax on the capital value of assets exclusive of agricultural land of individuals and companies. This tax would seem to come into conflict with the State's power to levy the tax on land and buildings. This conflict is resolved by holding that a tax on land and building is a direct tax on the property as such, whereas a tax on the capital value of assets is on the aggregate value of all assets, wherein lands and buildings are only components. Therefore in a tax on the capital value the unit of taxation is the aggregate value. A view seems to have been held that in a tax on capital value of assets the value of incumbrances should be excluded.

72. Article 276.
However as pointed out by the majority in *Union of India v. H.S. Dhillon*, discussed in the chapter on Residuary Powers, in a tax on the capital value of assets though there should be aggregation there need not be deduction of incumbrances. Similarly it is not incumbent on State legislature to provide for deduction of debits while levying a tax on land and building under entry 49 of List II. It is only in a wealth tax a provision is necessary for deducting the debits. Such a tax is sustainable on the residuary power.

6.36 Tax on land and building may be levied without reference to the use to which the building is put. An argument that lands and buildings occupied by factories should not be separately treated and taxed was rejected by the Supreme Court.

Tax on income and tax on agricultural income

6.37 Entry 46 of List II provides for the levy of taxes on agricultural income. From the power to levy tax on income conferred on the Union by entry 82 of List I, agricultural income is specifically excluded. A tax on income is defined as including a tax in the nature of excess profit tax, and agricultural income, as defined for the purposes for the enactments relating to Indian income tax. Income has been treated as any profit or gain which is actually received and therefore inclusive of a capital gain.

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78. Articles 366(29) and 366(1) respectively of the Constitution.
Agricultural income has been defined in section 2(1) of the Indian Income Tax Act, 1961. It has been given a wide connotation, for example, including all income from forestry operations. It has also been held that to determine the exact scope of agricultural income, the rules framed under the Income Tax Act should also be taken into account. In view of the importance of the definition of the agricultural income from the State's point of view it has been specifically provided in the Constitution that no bill that attempts any change in the meaning of agricultural income as defined in the Income Tax enactments shall be introduced or moved in Parliament except on the recommendation of the President.

OTHER MISCELLANEOUS TAXES

Excise duty and taxes on luxury

The power to levy excise duties on alcoholic liquors for human consumption, opium, hemp and other narcotic drugs and narcotics but excluding medicinal and toilet preparations containing these substances has been given to the States. Excise duties in respect of other articles may be levied by the Union. Thus an excise duty on tobacco is leviable by

82. Article 274 of the Constitution.
83. Entry 51 of List II.
84. Entry 84 of List I.
the Union. According to entry 62 of the State List, the States may levy a tax on luxuries. A question has been raised whether a licence fee for bringing, stocking and selling of tobacco would come under entry 64 of List I or entry 62 of List II. The Supreme Court held that since there was no nexus between production or manufacture and the tax, it will not come under entry 64. Though tobacco was not specifically stated as luxury in entry 62 of List II the term "luxury" should not be understood as something exclusively used by the rich. It denoted something which was superfluous and not indispensable to human life and which people took with a view to enjoy, amuse or entertain themselves. An expenditure on something which was in excess of what was required for economic and personal well-being would be expenditure on luxury although the expenditure might be incurred by a large number of people including those not economically well off. Judged on this basis tobacco was an article of luxury and the levy on tobacco would come under entry 62 of List II.