Introduction

In a federal structure, the provision of adequate financial resources for the general and regional governments is the most difficult problem. It is the problem of matching the financial resources with the respective functions of these governments. Dr. Wheare has stated the problem thus:\(^1\)

The federal principle requires that the general and regional governments of a country shall be independent each of the other within its sphere, shall be not subordinate one to another but coordinate with each other,...that both general and regional governments must each have under its own independent control financial resources sufficient to perform its exclusive functions.

But Dr. Wheare was talking of classical federation or a federation of Laissez faire era and even in that era it was more an ideal than a reality. It is the universal experience of the working of federations that no scheme of allocation of taxing powers results in creating a finance-function balance at each level. "There is and can be no final solution to the allocation of financial resources in a federal system. There can only be adjustments and re-allocation in the light of changing conditions."\(^2\)

"Usually", says Dr. Jain, "the Centre in spite of its own heavy commitments on defence and other services, does emerge with a much stronger financial capacity than the units, which always find their resources inadequate to match their responsibilities."\(^3\)

This is as aptly applicable to classical Federations of America,

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2. Id. at 123.
Australia and Canada as to India, the federal character of which has been the subject of deep controversy. So was observed by Shri Alladi Krishnaswami Ayyar, when he told the Constituent Assembly that although "an independent source or sources of revenue are certainly necessary for the proper functioning of a federal government, there is a distinct tendency, however, in the several federations, for the Central Government to act as the taxing agency, taking care to make adequate provision for the units sharing in the proceeds as also for the central or national Government granting subsidies." 

Just as in the area of distribution of legislative powers as also in the distribution of taxing power and revenue resources between the Central and State Governments, the Indian Constitution does not qualify to be called a classical federation. So far as the framing of financial provisions, the Assembly's approach merely 'exemplifies Birch's description of cooperative federalism.'

Before the sources of revenue were codified in the Constitution in List I and List II, there was held a prolonged debate in the Union Powers Committee of the Assembly over the items to be allocated to the two Governments. But, the Committee consented as mentioned earlier, in favour of the division of revenue made in the Government of India Act 1935 and also retained its financial scheme, with minor adjustments.

It is significant to note that, at no stage of the framing of these portions of the Constitution, as well as the financial provisions themselves, did the Provincial Governments claim for any of the tax-sources proposed to be allotted to the Union.


5. VII Constituent Assembly Debates, 336.

but they only pressed for greater share in the proceeds of taxes to be levied and collected by the Union. The provisions embodying this cooperative system of revenue distribution found place in the first two chapters of Part XII of the Constitution and can be roughly divided into four categories: the allocation of taxing powers and the distribution of tax receipts; the power of the Union to make grants-in-aid; the provisions regulating borrowing; and the article providing for the establishment of Finance Commission.

The Constitution of India can claim the merit, if that could be called a merit, of effecting a complete separation in the taxing powers of the Union and the States and, in that way, the possibility of double taxation has been totally precluded. The entire taxing area has been divided between the Union and the States, so to say, a tax leviable by the Union is not leviable by the States and vice versa. The constitutional scheme seeks to avoid the complexities of overlapping and multiple taxation, such as have arisen in other federations. The Concurrent List in the Seventh Schedule, authorising both the Union and the States to legislate on the subjects enumerated in it, contains only three tax entries which are of much significance. Thus in the matter of division of taxing power, the Indian Constitution may be placed in the category of true federal Constitution. However, on an


8. In the federations of America, Canada and Australia, there is no rigid separation of taxing powers between the Centre and the Units and both may levy many similar taxes simultaneously, on the same tax base. This has given rise to many acute problems of overlapping and multiple taxation in these countries.

9. These are: entry 35 (authorising the framing of principles on which taxes on mechanically propelled vehicles are to be levied); entry 44 (stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty) and entry 47 (authorising the levy of fees other than those taken in any court).

10. Dr. Diwan, 46.
analysis of tax entries, one would find that the division has given the Centre large and elastic taxing power and the States are left with inelastic and even eroding taxing power. This division of taxing power has resulted in the States to lean heavily on the Union for financial support. It was a deliberate act taken with a view that India as a single economic unit, needed a certain measure of Central coordination of social and economic activities of the States to ensure their balanced and harmonious growth. For that reason, the financial autonomy of the States has been made subject to the over-riding consideration of national economic development.

A. Distribution of Taxing Power

As already mentioned, the taxing powers are divided between the Centre and the States under the various Lists in the Seventh Schedule to the Constitution. The taxes enumerated in the Union List are leviable by the Centre exclusively while those mentioned in the State List are leviable by the State exclusively. The Constitution does not permit levy of any tax outside the tax entries. However, the residuary taxing power is vested in the Union by entry 97 of the Union List.

The provisions of the Constitution concerning the division of taxing power seem to have been designed with great care and circumspection with a view to forestal precisely the kind of difficulties that even the older federations do not appear to have overcome in regard to conflicting tax jurisdiction. The scheme has been drawn with the following considerations in view:

(i) that the Centre should have adequate resources at its command so as to be able to meet its functions of defence, etc.;

(ii) that the heads of revenue and responsibilities should be distributed on the basis of whether the Centre or the State is better equipped to deal with the particular head. It means the convenience of tax collection, which agency Centre or State


may levy and collect what tax from the point of view of administrative convenience, efficiency and effectiveness. For that reason, taxes having a localised base have been entrusted to the States;

(iii) that taxes where it is desirable to maintain uniformity of incidence throughout the country have been allotted to the Centre, e.g., stamp duties on negotiable instruments, taxes on transactions in stock exchanges;

(iv) that taxes that have inter-State base, i.e., of which the tax base or incidence is not localised but extends beyond the confines of one State or where aggregation may be necessary for purposes of levy of tax on a progressive basis, have been made over to the Centre, for example, income tax, customs duties, estate duty;

(v) that having regard to the trends all over the world to forge closer economic links in the form of common markets and economic groupings and keeping in view the economic development of the country, those taxes which have a close relationship with national economy and which if allotted to the States may create clogs on economic development, or may hinder the movement of inter-State trade or commerce or development of a common market in India, have been allotted to the Centre.

Given these facts due consideration, "there can be no room for argument that the levy and administration of taxes with wide economic base such as income tax, corporation tax, Union excise duties and of course also import and export duties will have to remain with the Union Government." At the same time, the framers of our Constitution rightly allocated to the States subjects such as agriculture, education, medical care, public health, irrigation and law and order that touch intimately the lives of the people. "These can be efficiently administered in a vast country only by the State Governments who are closer to the people and are more keenly alive to their problems and needs."

14. Ibid.
Thus, the taxes having inter-State base are assigned to the Centre while the States are given only taxes of a local nature. In the following paragraphs, the scope of the taxing power of the Union and the States with respect to each entry is discussed to give the subject more clear understanding.

(a) **Taxing Power of the Union**: The following tax entries are mentioned in the Union List and the taxes with respect to these are leviable exclusively by the Union:

**Entry 82. Taxes on income other than agricultural income**: Taxes on income are levied both by the Centre and the States. While the Centre has exclusive power to levy a tax on non-agricultural income, the tax on agricultural income is assigned to the States.\(^15\)

The term 'income' has not been defined in the Constitution and the word is, thus, to be interpreted according to its natural and grammatical meaning which means "a thing that comes in",\(^16\) and is thus a term of the 'broadest connotation'.\(^17\) It has been interpreted broadly by the Supreme Court as to embrace any profit or gain which is actually received.\(^18\) The term may thus include 'capital gains'\(^19\) or pension.\(^20\) It includes not only income which has actually accrued but also income which is supposed by the Parliament to have notionally accrued.\(^21\) Thus a loan advanced to a shareholder of a company can be treated as his income and taxed as such.\(^22\) It may mean the gross receipts, of a person and is not necessarily restricted to his profits or net receipts.\(^23\) A tax on income includes an excess profits tax.\(^24\)

\(^15\) Entry 46, List II, Seventh Schedule.
\(^17\) Kamakhya v. Commr. of I.T., AIR 1943 PC 153.
\(^18\) Navinchandra v. Commr. of I.T., AIR 1955 SC 58 at 61.
\(^19\) Ibid.
\(^20\) Raja Gopalachari v. Corp. of Madras, AIR 1964 SC 1172.
\(^24\) Article 366(29), Constitution of India.
Though the Union levies the tax on non-agricultural income, it, in fact, retains only a small share of the net proceeds of this tax, and the rest is distributed among the States.

**Entry 83. Duties of customs including export duties:** The duties are concerned with commerce with foreign countries and as such fall within the sphere of the Union which charges and controls these items.

**Entry 84. Duties of excise on tobacco and other goods manufactured or produced in India except -**

(a) alcoholic liquors for human consumption;

(b) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

Excise duty is a divided subject. The items excluded from the Union's purview under this entry fall within the State sphere under entry 51 of List II.

The term 'duties of excise' is of a very general and flexible import, and is often used to cover a variety of taxes on commodities. But the duty is primarily levied upon a manufacturer or producer in respect of the commodity manufactured or produced. It is a tax upon goods and not upon sales or the proceeds of sale of goods.

In *In re the Central Provinces and Berar Act 1938*, a question arose as to how to reconcile the entry 'duties of excise', in the Central List with the entry 'sales tax' in the Provincial List. In this Special Reference case made to the Federal Court under Section 213 of the Government of India Act 1935, Section 3(1) of that Act was interpreted as conferring jurisdiction upon the Federal Court to entertain the reference submitted to it.

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27. AIR 1939 FC 1.
of the Provincial Act, providing for 'the levy and collection from every retail dealer a tax on the retail sales of motor spirit and lubricants', was challenged by the Government of India on the ground that it was a 'duty of excise' and not a 'sales tax'. The Federal Court negativing the contention, held the tax valid. It pointed out that the primary and fundamental conception of the term 'excise' is that of a tax on articles produced or manufactured in a country.  

The term 'excise' has come to be restricted to a duty on manufacture or production of goods. The taxable event in respect of this duty is 'manufacture' or 'production'. A tax on the first sales of his products by a manufacturer is a 'sales tax' and not an 'excise' because it is a tax levied on him qua seller and not qua manufacturer. An excise can be collected at any stage. It does not cease to be so merely because the tax is imposed at a stage subsequent to the manufacture or production. It may be collected even from the consumers of the goods so long as it remains a tax on its manufacture. The duty is calculated according to the quantity of the value of the goods produced or manufactured and is not dependent on any commercial transaction in them.

A duty on coal raised at the collieries is a duty of excise. Though a natural product, yet the operations required to being the coal upto the surface, and make it usable, are so elaborate and expensive that coal may be regarded as covered by entry 84, as goods produced. But a tax on purchase of raw materials for manufacture of some commodity is not an excise but sales tax as the taxable event here is not production but sale.

In U.S.A., where the Central Government's power to levy direct taxes is very much restricted, the term 'excise' has come

28. Id. at 6.
32. Aluminium Corp. v. Coal Board, AIR 1959 Cal 222.
to be interpreted very broadly so as to enable the Centre to levy succession tax, corporation income tax and even general income tax, by characterising these taxes as 'excises'. In Australia 'excises' are outside the sphere of the States. There the term 'excise' has been very broadly interpreted as a tax on goods. Thus, many States' taxes on sale, use, consumption or production, have been characterised as excises and taken out of the States purview. In Canada, the Provinces are debarred from levying "indirect" taxes. They, in order to augment their resources started levying taxes on consumption, and thus placing the tax liability on the purchaser and making the seller a tax collector. But in India, the Courts have refused to interpret entry 84 so broadly and have restricted the concept of 'excise' to a tax on production and manufacture.

Entry 85. Corporation tax : Clause (6) of Article 366 defines the term 'corporation tax' as "a tax on income so far as that tax is payable by companies and is a tax in the case of which the following conditions are fulfilled :

(a) that it is not chargeable in respect of agricultural income;
(b) that no deduction in respect of the tax paid by the companies is, by any enactments which may apply to the tax, authorised to be made from dividends payable by companies to individuals;
(c) that no provision exists for taking the tax so paid into account in computing for the purposes, of Indian income tax the total income of individuals, receiving such dividends, or in computing the Indian income tax


35. Parton v. Milk Board, 80 CLR 229; Dennis Hotels Fvt. Ltd. v. Victoria, 104 CLR 529.

36. Atlantic Smoke Shops Ltd, v. Coulon, 1943 AC 550. The Privy Council has upheld such levy and has held that if a tax was paid by the person on whom it was levied and if its incidence was not passed on to someone else, it would not be an 'indirect' tax.
payable by or refundable to, such individuals.\(^{37}\)

It is the most elastic source of revenue in the hands of the Central Government, in the proceeds of which, the States are given no share.

**Entry 86. Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies;**

Taxes on the capital value of assets means a tax on the total assets owned by the assessee as distinguished from a tax on the components of the assets.\(^{38}\)

The Union can levy a wealth tax under this entry. Wealth tax being a tax on the total capital value of assets (including lands and buildings) minus the debts and liabilities and so falls under this entry.\(^{39}\) The expression 'individuals' includes a Hindu undivided family.

**Entry 87. Estate duty in respect of property, other than agricultural land:** This entry is to be read with entry 88 which says of 'duties in respect of succession to property other than agricultural land.' The term 'estate duty' means a duty to be assessed with reference to the principal value of all property passing upon death or deemed to pass under the said law.\(^{40}\)

'Succession duty' is a duty levied in respect of succession to property. The common element of these two duties is that the occasion for their levy is the death of a person. But while the estate duty is levied on the property itself, having relevance to its value and independent of the question as to who takes the property, \(^{41}\) in the case of succession duty it is the person who is charged in respect of the property he succeeds to.

The Centre under entries 87 and 88, could levy these duties in respect of non-agricultural property only while the levy in respect of agricultural property fell within the purview

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37. Article 366(6).
40. Article 366(9).
41. In re Estate Duty, AIR 1944 FC 73.
of the States. The question of levy of estate duty created difficulties. It was felt inequitable to levy it only in respect of non-agricultural property and leave agricultural land untaxed. At the same time, aggregation of the assessee's entire property when it might be interspersed over more than one State, presented hardships. To resolve these difficulties and to have uniformity, it was thought desirable to have recourse to Article 252, whereby a number of States authorised Parliament to legislate for levying estate duty in respect of agricultural land. The Estate Duty Act has been thus passed in 1953 under which estate duty is imposed on all property whether agricultural or non-agricultural.

Entry 89: Terminal taxes on goods or passengers carried by railway, sea or air; taxes on railway fares and freights: Terminal tax is a tax which can be imposed both on the entry in or exit from, of goods or passengers, a local area. The essential features of this tax are that the tax must be (i) terminal, (ii) confined to goods and passengers carried by railway, sea or air, (iii) chargeable at a rail, sea or air terminus and (iv) be referable to services (whether of carriage or otherwise) rendered by some rail, sea or air transport organisation. The tax is not concerned with the fact that whether the goods subjected to the tax are to be used in the local area or not. The nature of terminal tax has been discussed under entry 52 List II where its distinction with octroi has also been marked.

Entry 90. Taxes other than stamp duties on transactions in stock exchanges and future markets: 'Stock exchange and futures markets' is also a Union item and thus the whole area of stock exchanges falls to the Centre.

42. Entries 47 and 48, List II.
43. Article 252 provides for the Parliament to legislate with respect to matters contained in the State List when two or more State Legislatures resolve and consent to such legislation. The legislation so enacted may be adopted by resolution, by other States also.
44. Dr. Jain, 273.
45. Entry 48, List I.
Entry 91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

Entry 92. Taxes on the sale or purchase of newspapers and on advertisements published therein: The general sales tax falls in the State List. But to protect the newspapers which have an intimate connection with the freedom of speech and expression guaranteed as a fundamental right by the Constitution, sales tax on newspapers has been made a Central subject. It also avoids indiscriminate taxation.

Entry 92-A. 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: This entry was inserted by the Constitution (Sixth Amendment) Act, 1956, on the recommendations of the Taxation Enquiry Commission appointed in 1953. The Commission held that the Sales tax must continue to be a State tax and as a source of revenue, it must wholly belong to the States; and as a tax to be levied and administered, it must substantially pertain to the State Governments. But, the sphere of power and responsibility of the State, might be said to end and that of the Union to begin, when the Sales tax of one State impinged administratively on the dealers and fiscally on the consumers of another State. Broadly speaking the Commission recommended that inter-State sale should be the concern of the Union.

Though the taxes under this entry are levied and collected by the Centre but the net proceeds thereof, in their entirety, are made over to the States in whose territory the tax is levied and collected.

46. Entries 53 and 54, List II.
47. Dr. Jain, 271.
49. Article 269(1)(g).
Entry 96. Fees in respect of any of the matters but not including fees taken in any court except the Supreme Court: Fees taken in the Supreme Court is a Central item under entry 77 of Union List. Fees taken in all other courts is a matter mentioned in the State List. Fees taken elsewhere in respect of all matters enumerated in the Union Lists fall within the purview of this entry so to say, within the Central sphere.

Entry 97. Any other tax not mentioned in Lists II and III: It is a residuary entry, thus conferring power on the Union to impose 'residuary taxes'.

(b) Taxing Power of the States: The State List contains the following taxes which are leviable exclusively by the States:

Entry 45. Land revenue including its assessment and collection: Land revenue is a tax on the net produce of land and is levied at a flat rate with no exemption limit. It is a tax and not a rent for land. In the past, land revenue was the most important tax levied and collected by the Provinces. But today it is next in importance to sales tax and State excise duties. It has always been an inelastic tax and the revenue from it does not expand with an increase in prices or in the output from land. The tax is revised only after a re-settlement which involves a detailed survey and imposes heavy strain on the administrative machinery. The State Governments, due to political reasons, are found reluctant to impose any additional tax on land as it directly affects the agriculturists.

There is a strong case to reform the present system of land revenue or to replace it by a tax which takes account of the income and circumstances of the landowner. The Planning Commission has been advising for raising additional resources from the agricultural sector. But as a part of political move to create a dramatic impact on the agricultural sector, which yields a large political influence in an agricultural country.

50. Entry 3.
51. The term 'fees' has been defined in the following pages.
52. Discussed infra.
under adult suffrage, various State Governments moved to abolish land revenue or at least to exempt from the tax small land-holdings. The tax used to be the mainstay of State finances under the British rule, but it has now lost its importance.

Entry 46. Taxes on agricultural income: 'Agricultural income' means "agricultural income as defined for the purposes of the enactments relating to the Indian income-tax." Article 274(1) requires that a Bill to modify the meaning of the term 'agricultural income' in the Income-Tax Act can be moved in Parliament only with the prior recommendation of the President. The definition of the term as given in the Income Tax Act is, thus, controlling, for the States, which cannot extend their own jurisdiction by adopting a wider definition of the term 'agricultural income'. The term 'agricultural income' may include for the purposes of taxation, income from forestry.

Tax on agricultural income, yields a small proceeds. It is imposed only in the States of Assam, Bihar, Karnataka, Kerala, Maharashtra, Tripura, Tamil Nadu and West Bengal. It has been a controversial issue with the States, whether to levy the tax or not.

Entry 47. Duties in respect of succession to agricultural land:

Entry 48. Estate duty in respect of agricultural land:

Entries 47 and 48 refer to passing of property to another on the death of a person and do not apply to transfers inter vivos and, therefore, a gift tax would not fall within any of these entries.

Entry 49. Taxes on lands and buildings: This entry confers power on the State Legislature to levy taxes on 'lands and buildings'
without any terms of limitation as to the manner in which the tax is to be levied. The tax is levied on the annual value of the property, payable by the owner. But the fact that the State tax adopts the same basis 'annual value' - for determining income from property, as is done under the Income Tax Act, does not render the tax on 'lands and buildings' as a tax on 'income'. It would be a tax on the property and not a tax on income. A tax on the use of land as a market, falls under this entry as the incidence of tax falls on land and the tax is to be levied only if land is used for a particular purpose. Similarly, a tax on holding is a tax under this entry even though it is based on the annual value of the holding, and such annual value is calculated on the basis of the royalty payable to the Government in the case of mining land. It is a tax on the property and is based either on its capital value or on the annual letting value of the property. If it is imposed merely on the basis of floor area of the building then such a tax may be bad: being unequal or discriminatory.

The word 'land' in entry 49, is broad enough to include all land whether agricultural or not. Further the Supreme Court has said that the entry should be construed as "taxes on land" and "taxes on buildings" and therefore a tax on 'land' alone can be levied. Land includes not only the surface but also the area beneath the surface, so as to authorise a tax on ground occupied by electric supply lines. The entry includes buildings occupied by a factory but not the plant machinery or furniture attached to the land.

60. Ajoy v. Local Board, AIR 1965 SC 1561.
64. Asstt. Commr. v. B & C Co., AIR 1970 SC 169. In this case, it was contended that entry 49 referred to lands and buildings and that a tax merely on "land" could not be imposed. But the Court rejected the argument.
Entry 50. Taxes on mineral rights subject, to any limitations imposed by Parliament by law relating to mineral development: 'Regulation of mines and mineral development' is a Union subject and Parliament can legislate in this area to the extent to which such regulation and development is considered expedient in the public interest. Thus Parliament can impose limitations on this tax imposed by the States. It is provided, for the reasons, that iron, mica, manganese, copper and sulphur—all these minerals are of national importance and it would not be reasonable to give the States unconditional rights over this important item.

Entry 51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:

(a) alcoholic liquors for human consumption;
(b) opium, Indian hemp, and other narcotic drugs and narcotics, but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

The nature of an 'excise duty' has already been discussed under entry 84 of Union List. The distinction between an excise and sales tax has also been marked. The State thus may impose simultaneously an excise duty and a sales tax on the same commodity.

The entry gives power to the State Legislature to levy countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India. Such duties can only be levied on goods entering the State from outside if similar goods being manufactured within the State are subjected to excise duties. The duties are meant to equalize the tax burden on...
home production and imports so that the local manufacturer is not to be at a disadvantage. Further, the duty is levied on the entry of goods and not on goods being taken out.

It is not necessary that the goods must be consumed within the very State or Territory which imposes the excise duty.\(^70\)

Narcotic is a substance which relieves pain, produces sleep and when taken in large doses, brings on stupor, coma, and even death, as opium does.

As seen earlier 'excise duty' is a divided subject. Moreover, the proceeds of the excises levied by the Centre are not to be enjoyed by it alone but they are to be shared with the States.\(^71\)

The underlying idea of assigning excise duty on alcoholic liquors and other goods mentioned in entry 51, is to enable the states to promote the policy of temperance and prohibition.\(^72\) It is a different matter as to in what degree the States have been able to translate the policy into practice, or whether they have used this as a source of revenue.

**Entry 52.** Taxes on the entry of goods into a local area for consumption, use or sale therein: The tax levied under this entry is commonly known as octroi duty. The words 'consumption' and 'use' do not mean that the goods must be destroyed or used up in the process, for example, wheat imported into the municipal limits by flour mills for converting it into flour, is taxed under this entry as conversion into flour by grinding involves an user of wheat. It is not essential that the flour shall be

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\(^71\) Under Article 268, excise duties on medicinal and toilet preparations are levied by the Union but are collected and appropriated by the States within which such duties are respectively leviable. Article 272 provides for permissible, sharing of the States in the proceeds of other excises levied by the Centre.

consumed in the State itself. The tax, so to say, an octroi
tax leviable by the State under this entry differs from the
terminal tax leviable by the Union under entry 89 of the Union
List. Broadly speaking, a 'terminal tax' is also a kind of
Octroi, but it is concerned only with the entry of goods in a
local area irrespective of whether the goods are to be used
there or not. The essential features of the tax or octroi duty
leviable under entry 52 are (a) the entry of goods into a
definite local area, and (b) the requirement that the goods, should
enter for the purposes of consumption, use or sale therein.
Further, the tax under this entry refers to goods and not to
passengers, viz., it can be imposed only on entry of goods and
there is no limitation on the manner by which the goods enter
whether by rail, air, road or waterways.

A question as to the meaning of the expression, 'local
area' used in the present entry arose in Diamond Sugar Mills v.
Uttar Pradesh. The State of Uttar Pradesh declared each sugar
factory in the State as a local area and imposed a cess on entry
of sugarcane for consumption therein. The Supreme Court held
that the cess was not validly levied under this entry as the
term 'local area' signifies "an area administered by a local
body like a municipality, a district board, a local board, a
union board, a panchayat or the like", and the premises of a
factory is not a 'local area'.

Octroi can be levied on the commodity on its entry into a
local area, for the purposes of consumption, use or sale.
However, it is not necessary that the goods brought in for the
purpose of sale are wholly to be consumed by the purchaser
within the municipal limits. The Burmah Shell Company used to
bring petrol within Belgaum Municipal limits, consume a
part of it, sell a part of it to the consumers within the
municipal limits for consumption outside and export the rest

74. AIR 1961 SC 652.
outside the municipal limits of Belgaum. The Supreme Court held in *Burmah Shell Co. v. Belgaum Municipality* that except for the petrol exported, all petrol brought into the area was subject to octroi under this entry. The goods brought into the local area but were exported out within a specified period are not subject to levy under this entry.

**Entry 53. Taxes on the consumption or sale of electricity:**
A levy of duty on consumption of electrical energy is not a duty of excise falling under entry 84 of List I, because excise is a duty on 'production' and not on 'consumption'. For the reason, the State Legislature is competent to tax 'consumption' of electricity whether produced by the consumer himself or purchased from somebody else. Articles 287 and 288 have imposed some restrictions on the levy of this duty. Article 287 lays down that a State cannot impose a tax on the consumption by or sale of electricity (whether produced by a government or other persons) to the Government of India, or electricity consumed in the construction, maintenance or operation of a railway by or electricity sold for the purpose, to the Government of India or a railway company. Article 288, *inter alia*, provides that a State law, imposing a tax on electricity stored, generated, consumed, distributed or sold by an authority established by a law of Parliament enacted for regulating or developing any inter-State river or river valley, shall be reserved for the President's consideration and to be effective, should receive his assent. The purpose here is to protect the public utility services like railways and river valley projects from indiscriminate State taxation as these services have a national importance.

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75. AIR 1963 SC 906.
78. However, Parliament may authorise by law, the imposition of such a tax, but in that case, the incidence of the tax is to be on the producer of the electricity and not on the Government of India or the railway company. See Article 287.
79. Dr. Jain, 274.
Entry 54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.

The power to tax under the present entry can be availed of only where there has in fact been 'sale' as recognised by the general law. The expression 'sale of goods' in the entry has the same meaning, as is giving to it in the Sale of Goods Act. To constitute a 'sale', therefore, there should be an agreement between the parties for transferring title to goods, supported by money consideration, and as a result of the transaction, property must actually pass in the goods. There can be no sale without all these elements being present. The consumption by an owner of goods in which he deals is not a sale and cannot therefore be taxed under the present entry. For the reason, when a company manufacturing sugar and owning a fleet of motor trucks and a petrol pump for retail sale of motor spirit, cannot be taxed under the entry in respect of the petrol delivered to the company for consumption by its fleet, as there was no sale. Despatch of sugar by the assessee to the authorised agent of the State of Madras under direction given by the Sugar Controller under the Sugar and Sugar Products Control Order, 1946, was held not subject to sales tax as there was no sale since the contractual element was lacking in the transaction. However, when steel and iron products were supplied by the appellant to certain parties, under orders of the Steel Controller in pursuance of the Iron and Steel Order 1941, the Supreme Court held that although freedom to contract was controlled by law in the instant case, contractual element was not completely absent and was present to some extent, e.g., appellant could supply the goods at his convenience, and could fix the time and mode of payment of the price of the goods supplied, and thus the transaction was held

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83. Ibid.
as sale and so subject to sales tax,\textsuperscript{65} A hire purchase agreement is not an agreement of sale and so cannot be taxed under the entry. When such an agreement ripens into a sale, then sale is liable to sales tax.\textsuperscript{66} A State cannot impose a tax on forward contracts, because the entry authorises imposition of a tax on sale of goods', e.g., when there is a completed sale involving transfer of title or property in the goods and not as a mere agreement to sell.\textsuperscript{67}

The term 'goods' in the present entry, means all kinds of movable property. Electricity is 'goods' and tax can be levied on its sale.\textsuperscript{68} The power of the State to tax a sale under the entry is subject to the conditions laid down by Article 286, or any other provision of the Constitution. Article 286 is intended to ensure that sales taxes imposed by the States do not interfere with imports and inter-State trade and commerce, which are matters of national concern, and the taxation of which is beyond the competence of the States.\textsuperscript{69}

\begin{itemize}
\item \textsuperscript{85} I.S.W. Products v. Madras, AIR 1968 SC 478.
\item \textsuperscript{86} K.L. Johar & Co. v. Dy. C.T.O., AIR 1965 SC 1082.
\item \textsuperscript{87} Sales Tax Officer v. Budh Prakash, AIR 1954 SC 459.
\item \textsuperscript{88} S.T. Commr. Indore v. K.P.E. Board, AIR 1970 SC 732.
\item \textsuperscript{89} Article 286 lays down:
\end{itemize}

\begin{enumerate}
\item 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 take place
\begin{enumerate}
\item (a) Outside the State; or
\item (b) in the course of the import of the goods into, or export of the goods out of the territory of India.
\end{enumerate}
\item 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)
\item 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 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.
\end{enumerate}
Entry 55. Taxes on advertisements other than advertisements published in the newspapers and advertisements broadcast by radio or television.

Entry 56. Taxes on goods and passengers carried by road or inland waterways: It is a tax on passengers and goods and not on fares and freights. But it would not be invalid if it is collected through the operators in respect of passengers carried and goods transported by motor vehicles, who had realised it along with and is measured by fares and freight. It is a tax which is levied on goods and passengers carried by road or inland waterways. A tax on goods which enter or leave the municipal limits and having no relation to their transport cannot fall under this entry. The tax under this entry, however, can be made payable by the producer of the goods instead of the carrier, may be recovered with retrospective effect, but such retrospective operation of a validating law must not alter the nature of the original legislation. The goods taxed under the entry, may be carried for a long or short distance, but it is necessary for the levy of the tax that the goods must be physically carried through the State levying the tax. Physical carriage of goods is the taxing event under the entry.

Entry 57. Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tramcars subject to the provisions of entry 35, List III.

Entry 58. Taxes on animals and boats

Entry 59. Tolls: It is a tax realized for some service, amenity, advantage or benefit rendered to the taxpayer, for example, the use of a market or bridge or a road.

90. Inserted by the Constitution (42nd Amendment) Act, 1976.
Entry 60. Taxes on profession, trades, callings and employment: These taxes are commonly known as professional taxes. This entry is to be read with Article 276 which limits the amount of taxes on professions etc. to be paid by one person to Rs. 250 per annum. The tax under this entry may be imposed on professions and employments, including services, even though the employer is already paying income-tax. This tax may be imposed on trades or callings, e.g., on persons carrying on the trade of husking, milling or grinding of grains, or on the subject matter of the trade, e.g., each bale of ginned cotton or on the income arising from trade or profession. It may be levied on corporation, company, an artificial person. It may be measured by income derived from profession and may be made payable only if there is income. It is thus similar to a 'tax on income' which is a Central levy. In order to mitigate this overlapping and the evils arising from it, Article 276(2) prescribes the maximum amount payable by one person by way of taxes on profession etc., as Rs. 250 in a year. Under Article 276(2), the State as well as a municipality can separately levy a profession tax up to Rs. 250/- each on a person, because the word 'or' between the 'State' and 'any municipality' is used 'disjunctively' and not 'conjunctively'.

Entry 61. Capitation taxes: The tax is in the nature of zezia of Moghul system and is leviable on each head or person.

Entry 62. Taxes on luxuries including taxes on entertainments, betting and gambling: The words 'entertainments' and 'amusements' used in the entry are wide enough to include theatres, dramatic performances, cinemas, sports and the like.

The entry envisages a tax on the act of entertaining and it may be levied on the giver or the receiver of an entertainment or on both. A lottery or prize competition of a gambling nature are covered by the entry and a tax is leviable on a percentage basis on sums received by way of entry by their promoters. A tax on wagering contract may fall under this entry. A luxury tax can be imposed on tobacco as an item of luxury. Such a tax can be validly levied along with excise duty levied on tobacco.  

**Entry 63. Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to stamp duty.**

**Entry 66. Fees in respect of the matters in State List, but not including fees taken in any court:** Court fees fall under entry 3 of State List and entry 78 of List I.

(c) **Taxing Power Under Concurrent List:** The concurrent list contains only three tax entries, viz., :

**Entry 35. Principles on which taxes on mechanically propelled vehicles are to be levied:** The taxes on mechanically propelled vehicles can be levied by the States under entry 57 of List II. This entry merely provides that the principles on which the taxes may be levied, in order that there should be uniformity of taxation throughout the country, can to be laid down by the Union. The expression 'principles of taxation' denotes the rules of guidance in the matter of taxation.  

**Entry 44. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty:** This entry is to be read in the light of entry 63 of State List and entry 91 of Union List. Under this entry read with entry 63 of List II, the State can levy stamp duty on the certificates of enrolment of an advocate.  

Entry 47. Fees in respect of any of the matter in this
List but not including fees taken in any court.

(d) Savings in respect of Certain Pre-Constitutional State Taxes:

Article 277. With a view to protect the finances of the States
and the municipalities from being dislocated by a sudden
discontinuance of those taxes which they had been levying earlier,
but could no longer levy after the commencement of the Constitu-
tion, Article 277 lays down that any tax levied by a State or
a local authority before the commencement of the Constitution on
a subject which now falls under the Union's jurisdiction may be
continued to be levied till such time that Parliament makes a
law to the contrary. Such taxes may be levied and applied to
the same purpose. Further, it is the existing range of the taxes
which is protected and not the expansion of the range of
taxation by subjecting new items to it or by increasing the rates
of the tax, or altering its incidence. 7

(e) Residuary Taxing Power: As already stated, the Constitution
vests in the Centre, the power to levy residuary taxes. Entry 97
in Union List runs thus: "Any other matter not enumerated in
List II or List III including any tax not mentioned in either
of those lists". To the same effect, Article 248 lays down that
"Parliament has exclusive power to make any law with respect
to any matter not enumerated in the Concurrent List or State
List". This power includes the residuary power to levy taxes. 8

'Residuary power' may be understood in the sense that
if no entry in any of the three lists covers a matter, then it
must be regarded as a matter not enumerated in any of the three
lists. Then it belongs exclusively to Parliament under Entry 97
of the Union List. Interpreting thus, the annual deposit scheme,
"envisaging the borrowing of money by the Central Government
from the tax-payers in higher income group, which is repaid to
them in instalments," has been held to have been enacted under
the residuary entry. 9 The gift tax has been held to fall under

8. Article 248(2).
this entry. It is not a tax on lands and buildings as units of taxation and so is not covered by Entry 49, List II, what is taxed is the transmission of title by gift, and the value of the lands and buildings is the only measure of the value of the gift. There being no entry covering such tax, it could only be levied under the residuary entry 97, List I. Another case of such taxation is the expenditure tax covered by no other entry in any list but levied in the exercise of residuary powers.

The scope of residuary power of taxation has been significantly pronounced by the Supreme Court in Union of India v. H.C. Dhillon. The question involved in this case was whether the Union could levy wealth tax on the assets of a person including agricultural land. The relevant Entries are Entry 86 List I - "Taxes on the capital value of the assets, exclusive of agricultural land..."; Entry 49 List II - "Taxes on lands and buildings"; and Entry 97 List I - "Any other matter not included in List II and List III".

It was argued that when Parliament was specifically excluded under an entry to make a law on a subject, it could not do so under the residuary entry. It meant that the object and effect of exclusion of 'agricultural land' from Entry 86 List I was to take such property out of the ambit of Entry 97 List I and Article 248. Another argument was that a subject would fall within residuary power only if it is not mentioned in any of the three Lists, and since the subject of wealth tax has been there in Entry 86 List I, it could not then fall within the residuary entry and that Parliament had to legislate within the ambit of Entry 86 List I, and could not go beyond the scope of that entry. The proponents of this view argued that the words 'exclusive of agricultural land' in Entry 86 List I, were words of prohibition.

12. AIR 1972 SC 1061.
13. The issue arose on the amendment by the Finance Act of 1969, of the definition of 'net wealth' to include the agricultural land in assets for the purpose of calculating tax on the capital value of net wealth, under the Wealth Tax Act 1952.
which meant that Parliament was prohibited from including capital value of agricultural land in any law levying tax on capital value of assets.

The Supreme Court, by a majority, however, upheld the validity of the impugned legislation and observed that its subject matter fell within Entry 97 List I. The minority speaking through Shelat J., took the view that the residuary power contained in Article 248 and Entry 97, List I, meant power in respect of matters not enumerated in any of the three lists. "Such a residuary power cannot therefore, be ordinarily claimed in respect of a matter already dealt with under an Article or an Entry in any of the three lists." That the subject of wealth tax fell within Entry 86, List I, and was therefore, taken out of the residuary power. In the opinion of Shelat, J., the amending Act fell under entry 49 of List II and not under Article 248 or Entry 97 of List I.

Speaking for majority, Sikri, C.J. (as he then was) expressed the view that the impugned legislation did not fall within the ambit of either Entry 86, List I or Entry 49 of List II. However, even assuming that the Wealth Tax Act as originally enacted was held to be a legislation under Entry 86 of List I, there was nothing in the Constitution to prevent Parliament from combining its powers under Entry 86, List I with its powers under Entry 97, List I. They were of the view that Article 248, was framed in the "widest possible terms" and so a matter not included in List II or in List III fell within the residuary field. No question need be asked whether the matter fell under List I or not. It meant that if the subject matter did not fall in List II or List III, the Parliament has power to legislate on it.

The interpretation given by the majority thus gives a new dimension to the powers of the Union and thus seeks to avoid any vacuum in the area of legislative powers as would have

15. Consisted of Shelat, Ray and Dua, JJ.
happened had the restrictive view, propounded by the minority, of residuary powers, been adopted by the Court. But it does not lay down any clear propositions. The content and the extent of residuary power exercisable under Entry 97 List I is still in a fluid stage.

(f) **Taxing Power of the Union with respect to State Matters:**

Though the keynote of the Indian Constitution is to secure an almost complete separation between Centre-State taxing powers, so that a tax leviable by the Centre is not leviable by the State and vice versa, it, however, makes adequate provisions for meeting certain contingencies needing uniform taxing laws for the whole country or for two or more States and for meeting the higher needs of the Centre during emergencies. Such a mechanism avoids the disadvantages which are inherent in a rigid scheme of distribution of taxing powers between the Centre and the States on a federal pattern. A scheme which may be appropriate at the time of constitution-making may need re-adjustments under the changing circumstances, and in this respect, the Indian Constitution can claim its merit.

Article 249 enables the Parliament to legislate with respect to a matter for which it has no power to make a law. It thus provides that when the Council of States passes a resolution, by a two-third majority, that it is necessary or expedient in the national interest that Parliament should make laws with respect to any matter enumerated in the State List, the latter can assume authority to legislate for a year, on any State subject matter. The power to legislate implies the power to enact a law levying a tax.

Further, there are many subjects in the State List, such as, public health, agriculture, forests, fisheries etc., which may, at time, demand common legislation for two or more

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16. Dr. Jain, 283.

States. Article 252, in this respect, provides for the delegation of power by two or more State Legislatures to Parliament so as to enable it to legislate with respect to a matter enumerated in the State List. Such a law would be operative in the States which have so resolved or consented to such exercise. The provision thus introduces an element of flexibility in an otherwise inherently rigid allocation of powers. Recourse to this provision may be made when a uniform law for the control and regulation of a subject in State List is essential and considered so by the States. The Estate Duty Act 1953, was enacted by the Union Parliament under Article 252, levying estate duty in respect of non-agricultural, as well as, agricultural property.

During the period during which a proclamation of emergency is in operation in the country under Article 352, Parliament is empowered by Article 250 to legislate with respect to any matter contained in the State List. In this way, if need be, the Union can even levy taxes which in normal times fall in the State field.

The merit of the Indian Constitution, thus, lies in the fact that it has completely separated the taxing powers of the Centre and the States thereby avoiding the complexities of overlapping and multiple taxation. Along with it, the Constitution has woven adequate provisions into the scheme of allocation of taxing powers, so as to mould it to respond to the needs of the situation.

P. Distinction Between a 'Tax' and a 'Fee'

The distinction between a 'tax' and a 'fee' is of great practical importance. While no tax can be levied outside the tax entries, fees can be levied in respect of a non-tax entry as well. Another important difference is that Articles 110 and 199, which deal with 'Money Bills' lay down expressly that, a Bill will not be deemed to be a 'Money Bill' by reason only that it provides for the imposition of a fee, whereas, a Bill dealing

18. Article 265.
with the imposition or regulation of a tax will always be a Money Bill. This raises the question as to how to distinguish between a tax and a fee.

Although there is no generic difference between a 'tax' and a 'fee', but the Indian Constitution recognises a clear distinction between them for legislative purposes. The distribution of power between the Centre and the States to levy a tax is not identical with that of the power to levy a fee. While taxes are specifically distributed as between the Centre and States by various entries in List I and List II (which are known as tax entries), there is an entry at the end of each list as regards fees which may be levied in respect of or as incidental to the matter that is included in that list. The result is that each Legislature (Central or State) has the power to levy a fee which is co-extensive with its power to legislate with respect to substantive matters and that either Legislature may, while enacting a law relating to a subject matter within its legislative competence, levy a fee with reference to the services that would be rendered by the State under such law. It implies that fees have special reference to the governmental action undertaken in respect of any of the matters within its competence. Thus a fee may be levied as incidental to legislation with respect to any entry, whereas, no taxes may be imposed by virtue of the general legislative power.

The Supreme Court had the first occasion of distinguishing a tax from a fee in the case Commissioner of H.R.E. v. L.T. Swamiar. The Court observed that a 'tax' is a compulsory exaction of money by a public authority for public purposes, to meet the general expenses of the State without reference to any special benefit to be conferred upon the tax-payers. The taxes collected are merged in the general revenue and applied for general public

19. Articles 110(1)(a) and 110(2); Articles 119(1)(a) and 119(2).
20. The relevant entries are: Entry 96, List I, Entry 66, List II and Entry 47, List III.
22. Ibid.
purposes. Fees, on the other hand, are payments for some special service rendered, or some work done for the benefit of those from whom payments are demanded. Thus, in fees, there is always an element of *quid pro quo*, which is absent in a tax.

Further, while a tax is paid for the common benefit conferred by the Government on all tax-payers, a fee is a payment made for some special benefit, enjoyed by the payer and the payment is usually proportional to the special benefit. The object of the levy of tax is to raise the general revenue, whereas, the money raised by a fee is set apart and appropriated specifically for the performance of the service for which it has been imposed and is not merged in the general revenues of the State. An Orissa Act laid down that every temple having income exceeding Rs.250, should make an annual contribution, on a percentage basis on the income for meeting the expenses of the Commissioner of Hindu Religious Endowments and his staff - the machinery set up for due administration of the affairs of the religious institutions. The collections were to form a separate fund and were in consideration of services rendered, namely, to ensure proper application of the endowment funds. The levy was held to be a fee. But, a levy on religious institutions was held to be a 'tax' and not 'fee' when the money so raised was not earmarked for defraying the expenses in performing the services. The collections went to the State Consolidated Fund, out of which were met the expenses of the Commissioner. There being no co-relation between the expenses incurred by the Government and the contributions raised, the levy being a tax was held unconstitutional as it did not fall under any tax entry in List II.

A levy in the nature of a 'fee' does not cease to be so merely because there is an element of compulsion present in it,

or because it has no direct relation to the actual services rendered - a reasonable relation between the levy and the expenses for maintaining the service would be enough to make it a fee. Thus, the fee payable by a factory under the Factories Act has been held to be a 'fee' as the inspection carried on by the inspectors confers benefit on the factory owners as well.\textsuperscript{27}

While in the case of a tax, there is no \textit{quid pro quo} between the tax-payer and the State, there is a necessary co-relation between the fee collected and the service intended to be rendered. Further, the amount of fee is correlated to the expenses incurred by the State in rendering the services, but the amount so recovered may not arithmetically commensurate with the expenses.\textsuperscript{28}

In assessing a fee, no account is taken of the varying abilities of the different assesses, whereas the quantum of imposition of a tax upon a tax-payer depends generally upon his capacity to pay.\textsuperscript{29}

However, a levy in consideration of rendering services of a particular type will not be regarded as a tax merely because of the absence of uniformity in its incidence or that the element of compulsion was present in the collection thereof or that some of the contributories were not obtaining the same degree of service as others got.\textsuperscript{30} For that reason, in \textit{Hingir-Rampur Coal Co. v. State of Orissa}\textsuperscript{31}, a levy on lessees of coal mines to meet the expenditure for providing amenities like communication, water supply and electricity for the better development of the mining area, and to meet the welfare of the labour employed was held a 'fee'.

Whether or not a particular cess levied by a State amounts to a fee or a tax, would always be a question of fact to be

\textsuperscript{27} D.C.\textit{Mills v. Chief Commr., Delhi}, \textit{AIR 1971 SC 344}.  
\textsuperscript{29} \textit{Commr., H.R.E. v. Lakshmindra}, \textit{AIR 1954 SC 282}.  
\textsuperscript{30} \textit{Hingir-Rampur Coal Co. v. Orissa}, \textit{AIR 1961 SC 459}.  
\textsuperscript{31} \textit{Ibid.}
determined in the circumstances of each case. Cases may arise where under the guise of levying a fee, the Legislature may attempt to impose a tax. In the case of such a colourable exercise of power, Courts would have to scrutinise the scheme of the levy very carefully and determine whether, in fact, there is a co-relation between the services and the levy or the levy is excessive to such an extent as to be a pretence of a fee and not a fee in reality.\(^{32}\)

In the cases cited above, the Supreme Court has observed that one of the essential elements of 'fee' was that the amount of fee collected must be set apart or specifically appropriated for the rendering of services. But later in *Secretary, Government of Madras v. Zenith Lamp & Electrical Ltd.*,\(^{33}\) the Court ruled out this view and observed that the Constitution did not contemplate it to be an essential element of fee that it be credited to a separate fund and not to the Consolidated Fund. This view is again expressed by the Court in a recent judgement.\(^{34}\) There the Court observed: "it is now increasingly realised that merely because the collections for the services rendered or grant of a privilege or licence, are taken to the Consolidated Fund of the State and are not separately appropriated towards the expenditure for tendering the service, is not by itself decisive." The Court further said that the element of *quid pro quo stricto senso* is not always a *sine qua non* of a fee. Referring with profit to the observations of H.M. Seervai,\(^{35}\) the Court held that if the services rendered are not by a separate body like the Charity Commissioner, but by a Government department, the character of imposition would not change because under Article 266 the moneys collected for the services must be credited to the Consolidated Fund.\(^{36}\)

33. AIR 1973 SC 724.
C. Restrictions on Taxing Powers

The Constitution imposes some restrictions on the taxing powers of the Centre and the States. Apart from the limitations imposed by the division of the taxing powers between the Centre and the States by the relevant entries in the legislative Lists these may be discussed under the following heads:

1. No Taxation Save by Authority of Law

Article 265 lays down that "no tax shall be levied or collected except by authority of law". The Article provides that not only the levy but also the collection of a tax must be under the authority of law. It embodies the English principle of 'no taxation without representation'. The term 'law' in this Article means statute law, i.e., an act of the Legislature. Accordingly, no levy can be imposed either by an executive action, or by the

38. Bimal v. State of M.P., AIR 1971 SC 517. There was a difference of opinion among the High Courts regarding the exact significance of the word 'law' in this Article. The other view was that 'law' does not mean statute law alone and that a levy on land imposed under a custom as an incident of the possession of any property or holding of an office is not ruled out. Madhwni v. Rajasthan, AIR 1958 Raj 138; S.Copelan v. Madras (1956) 2 Mad 117. But after the Supreme Court decision in Kerala v. Joseph, AIR 1958 SC 296, a customary imposition is no longer valid under Article 265.
resolutions of the Houses of the Legislature,\textsuperscript{40} or by subordinate legislation in the absence of express statutory authority for the charge.\textsuperscript{41}

Further, the law must be a valid law, which means that -

(i) the tax proposed to be levied must be within the legislative competence of the Legislature imposing the tax.\textsuperscript{42}

(ii) The law must be validly enacted, i.e., by the proper authority which has the legislative competence and in the manner required to give its acts the force of law.\textsuperscript{43}

(iii) It must not also contravene the specific provisions of the Constitution which impose limitation on legislative power relating to particular matters, e.g., Articles 27,\textsuperscript{44} 276,\textsuperscript{45} 286,\textsuperscript{46} 301,\textsuperscript{47} etc.

(iv) The law must not be a colourable use of or a fraud upon the legislative power to tax.\textsuperscript{48}

(v) The law or the relevant portion thereof should not violate the conditions laid down in Article 13, i.e., it must not violate a fundamental right.\textsuperscript{49}

It may also be made clear that taxation is treated as a distinct matter for purposes of legislative competence and is not included in the main subject of legislation. For the reason

\textsuperscript{40} Attorney General v. Wilts United Dairies (1921) 37 TLR 834.
\textsuperscript{41} Maheshwari v. U.P., AIR 1957 All 282; Gopal Narain v. Bihar, AIR 1964 SC 370.
\textsuperscript{42} Poona Municipality v. Datterays, AIR 1965 SC 555.
\textsuperscript{43} Bharat Kala Bhander v. Khamangaon Municipality, AIR 1966 SC 249.
\textsuperscript{44} Commr. H.R.R. v. Lekshmindra, AIR 1954 SC 282.
\textsuperscript{45} Chhotabhai v. Union of India, AIR 1962 SC 1006
\textsuperscript{46} Bombay v. United Motors, AIR 635 SC 252.
\textsuperscript{47} Atiabari Tea Co. v. Assam, AIR 1961 SC 232.
\textsuperscript{49} Chhotabhai v. Union of India, AIR 1962 SC 1006; Moopil Nair v. Kerala, AIR 1961 SC 552.
a tax cannot be levied outside the specific tax entries enumerated in the three lists in the Seventh Schedule. Thus, a tax can be levied only under a 'tax' entry and not under a non-tax entry as an ancillary or incidental matter. For example, the subject of 'betting and gambling' is Entry 34 in List II while taxes thereon is Entry 62 in the same List. The Mysore Legislature passed a resolution under Article 252 conferring on Parliament, the power to make law in regard to control and regulation of prize puzzle competitions and all matters incidental thereto. Later, the legislature levied a tax on prize competitions. On being challenged, the tax was held to be validly levied. The Supreme Court held that the subject of 'betting and gambling' and the taxes thereon are separate powers, and where control on prize competitions was surrendered to Parliament by the resolution, the power to tax was not surrendered.

Article 265 however, is not a bar against giving retrospective effect to taxing laws.

2. State's Power to Levy Taxes on Professions and Trades

It has already been stated that a tax imposed by a State under Entry 60, List II, on professions, trades, callings and employments, is very similar to a tax on income which falls in the Union List. The Constitution recognises this overlapping and to mitigate the evils arising from it, Article 276(2) lays down that the total amount payable by one person to the State or to any one municipality in the State by way of this tax, shall not exceed Rs. 250 per annum.

52. The Legislature under the Constitution can legislate retrospectively (except in the matters of Criminal Laws, Art. 21(1)) and taxing laws are no exception to their power. Muhammadbhai v. Gujarat, AIR 1962 SC 1517; Union of India v. Madanagopal, AIR 1954 SC 158.
3. **State's Power to Levy Taxes on Electricity**

   Articles 287 and 288 exempt from State taxes, electricity or water consumed by Union agencies.\(^{53}\) They partially incorporate the doctrine of 'immunity of instrumentalities' in relation to the Union.\(^{54}\) Article 287 provides that save in so far as permitted by Union legislation, no State shall tax the consumption or sale of electricity which is consumed by the Government of India itself or a railway company in the construction, maintenance or operation of a railway. Article 288 exempts from State taxation, subject to any order of the President to the contrary, water or electricity generated, consumed, distributed or sold by any authority established for regulating or developing any inter-State river or river-valley.

4. **State's Power to Levy Sales Taxes**

   As stated already,\(^{55}\) the power to impose taxes on "sale or purchase of goods other than newspapers" belongs to the State.\(^{56}\) But taxes on "imports and exports"\(^{57}\) and "inter-State trade and commerce"\(^{58}\) and "taxes on sale or purchase of goods, other than newspapers, in course of inter-State trade or commerce"\(^{59}\) are exclusive Union subjects. The object of Article 286, under which the State's power to levy 'sales tax' has been subjected to a few restrictions, is to ensure that sales taxes imposed by the States do not interfere with imports and exports and inter-State trade and commerce, which are matters of national importance. It is to regulate taxation of inter-State sale or purchase lest an indiscriminate State taxation may hamper free flow of trade and

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53. See supra.
54. Basu, 343.
55. See supra.
56. Entry 54, List II.
57. Entry 83, List I.
58. Entry 42, List I.
59. Entry 92A, List I.
commerce from one State to another and thus jeopardise the economic unity of the country.  

Article 286, hence, with a view to keep inter-State and international trade and commerce and trade in the goods of special importance, free from haphazard State taxation, subjects the States' power to levy sales tax to the following restrictions:

(a) No State can tax a sale or purchase taking place outside the State.  
(b) No State can tax a sale or purchase taking place in the course of inter-State trade and commerce.  
(c) No State can tax a sale or purchase taking place in the course of import and export.  
(d) Restrictions could be imposed by Parliament, on the powers of State Legislatures with respect to the levy of tax on sale or purchase of goods within the State where the goods are declared by Parliament, to be of special importance in inter-State trade or commerce.  

(i) Tax on Sale or Purchase - Outside a State and in Inter-State Trade and Commerce

A 'sale or purchase' constitutes of many ingredients, e.g., existence of goods; agreement to sell; passing of property in the goods; delivery of goods; payment of the price and the like. A sale is complete only when each of these ingredients is present. It would be a completely intra-State sale when all these ingredients take place within one State, and that State can tax the same. When none of these ingredients takes place in a State, the sale is completely outside it and it cannot levy any tax on it. However, when these ingredients take place not in one State but touch several States, the sale is known as

60. Dr. Jain, 287.  
61. Article 286(1)(a).  
62. Article 286(1)(a).  
63. Article 286(1)(b).  
64. Article 286(3).
inter-State sale. Such a sale could be subjected to tax by each of such States. The multiple taxation so resulting, adversely affect inter-State trade and commerce and thus requires some formulae to avoid such a situation.

Before 1956, taxes on the sale or purchase in the course of inter-State trade or commerce were within the purview of the States but Article 286 sought to avoid multiple taxation of sales by stipulating that no law of a State could impose a tax on the sale or purchase of goods in the course of inter-State trade or commerce unless Parliament by law provided otherwise. Thus the States were debarred from levying a tax on sale or purchase taking place outside the State or in the course of inter-State trade and commerce. A sale was deemed falling within the State, in which goods under it were actually delivered for consumption. Interpreting Article 286 in State of Bombay v. United Motors Ltd., the Supreme Court adopted the 'outside consumption' test and held that the exporting State could not tax a sale under which goods went to another State and that the sale could be taxed only by the State in which the goods were actually delivered for consumption. The word 'consumption' was interpreted broadly so as to mean not only consumption by the actual purchaser himself but also distribution for eventual consumption within the State. But if the goods were not delivered in a State for consumption, i.e., when the goods were re-exported to another State, then it was the latter State which could tax the sale. The States resorted to the practice of taxing inter-State sales under which goods came to them for consumption, but placed the liability to pay the tax on the out-of-the-State dealers. Though, the practice was adopted for the convenience of tax collection but created difficulties for the

65. In 1956, by the Constitution (Sixth Amendment) Act, Article 286 was amended.
66. Article 286(2) prior to amendment of 1956.
67. Explanation to Article 286(1), prior to 1956.
68. AIR 1953 SC 252.
trader sending goods to several States, as he could be taxed by all the States. The Supreme Court had the occasion to look into the matter again in *Bengal Immunity Co. v. State of Bihar*. In this case, a company in Calcutta accepted orders there and then sent goods to dealers in Bihar. The State of Bihar sought to tax the company's sales to Bihar dealers, which was objected to by it. Overruling its earlier decision in *Bombay v. United Motors*, the Supreme Court now held that it was an inter-State sale which could not be taxed by any State, by virtue of Article 286(2). 'Inter-State sale' thus became immune from all State taxation. To ensure that the inter-State trade and commerce should not go absolutely tax-free and pay tax at least once, Article 286 was amended in 1956 by the Constitution (Sixth Amendment) Act. The amended Article 286 brought the taxes on the sale in the course of inter-State trade and commerce within the purview of the Parliament. Entry 92A running as "taxes on the sale or purchase of goods other than newspaper, where such sale or purchase takes place in the course of inter-State trade or commerce", was thus, added to List I. Accordingly, Parliament enacted the Central Sales Tax Act 1956, so as to levy a tax on inter-State sale or purchase. Further, the amended Article 286 empowered Parliament to impose restrictions and conditions on a sale or purchase of goods within the States, if the sale relates to goods declared by Parliament to be of special importance in inter-State trade and commerce. Power was given to Parliament to formulate principles for determining when a sale or purchase takes place 'in the course of inter-State trade or commerce, or 'in the course of export or import or outside a State.

Sections 3 and 4 of the Central Sales Tax Act, 1956 incorporate principles for determining when a sale or purchase of goods is said to take place in the course of inter-State trade or commerce and when a sale or purchase of goods can be said to take place outside a State. A sale or purchase of goods is deemed to

69. AIR 1955 SC 661.
70. AIR 1953 SC 252.
71. Amended Article 286(3), (hereinafter cited as Article 286).
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 affected by a transfer of documents of title to the goods during their movement from one State to another. Section 4 of the Central Sales Tax Act states as to when a sale or purchase shall be deemed to have taken place outside a State. It says that "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". According to subsection(2) of Section 4, a sale or purchase shall be deemed to have taken place inside a State if the goods are within the State (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 time of their appropriation to the contract of sale by the seller or by the buyer, the assent of the other party to the appropriation may be prior or subsequent to such appropriation. It is thus clear from Section 3 read with Section 4 that the test to ascertain an "inside sale" is the existence of goods within the State. Explanation to Section 4, further makes it clear that if there is a single contract of sale or purchase and the goods are situated at more places than one, it will be presumed that separate contracts of sale were made in respect of the goods situated at each of such place. Thus in order to impress a sale with the character of an inter-State trade or commerce, the terms of the sale should provide for the delivery being effected in another State, i.e., the delivery outside the State should be pursuant to a contractual obligation. Two essential conditions of inter-State trade or commerce were that there should be a sale of goods and movement of those goods across the border of the State under a contract of sale, i.e., the delivery outside the State should be a term of the contract.

73. Singareni Collieries Co. v. Andhra Pradesh, AIR 1962 AP 75.
(ii) **Sale or Purchase in the Course of Import**

Clause (1)(b) of Article 286 debars a State from imposing a tax on sale or purchase of goods which takes place in the course of import of goods into India. According to Section 5 of the Central Sales Tax Act 1956, a sale or purchase shall be deemed to have taken place in the course of import if "such sale or purchase 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". The "course of import" of goods starts at a point when the goods cross the customs barrier of the foreign country and ends at a point in the importing country after the goods cross the customs barrier. Accordingly, the sale which occasions the import is the sale in the course of import.

A purchase by a dealer in cashew nuts at Madras from an agent of an African firm which results in despatch of goods from Africa for import into India is a sale which occasions the import of goods. Further, a purchase by an importer of goods when they are on the high seas by payment against shipping documents is also a purchase "in the course of import" and sale by an importer of goods after the property in the goods passes to him, either after receipt of the documents of title against payment or otherwise, to a third party by a similar process is also a sale in the course of import. The sale by an importer, pursuant to an earlier contract entered into with the Government of India by delivery of the shipping documents, including the bill of lading to the Government against payment, when the goods were on the high seas was held to be a sale "in the course of the import of goods into India."\(^7^4\)

(iii) **Sale or Purchase in the Course of Export**

In an earlier case the Supreme Court sought to give meaning to the words "in the course of export" by laying down the

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following proposition:

A sale by export ... involves a series of integrated activities commencing from the agreement of sale with a foreign buyer and ending with the delivery of the goods to a common carrier for transport out of the country by land or sea. Such a sale cannot be dissociated from the export without which it cannot be effectuated, and the sale and resultant export form parts of a single transaction..... whatever else may or may not fall within article 286(1)(b), sales and purchases which themselves occasion the export or the import of the goods, as the case may be, out of or into the territory of India, come within the exemption.

In Travancore-Cochin v. Shanmuga Vilas Cashewnut Factory, the phrase "integrated activities" was explained to be used:

to denote that "such a sale" (i.e., a sale which occasions the export) cannot be dissociated from the export without which it cannot be effectuated, and the sale and the resultant export form parts of a single transaction'. It is in this sense that the two activities - the sale and the export - were said to be integrated. A purchase for the purpose of export like production or manufacture for export, is only an act preparatory to export and cannot... be regarded as an act done 'in the course of the export of the goods out of the territory of India' and more than the other two activities can be so regarded.

Following this decision, the Supreme Court held in Mysore v. Mysore Spg. & Mfg. Co. Ltd. that sales made for the purpose of export, were not protected unless they themselves occasioned the export and consequently all sales that preceded to one that occasioned the export were taxable even if the goods were manufactured with the main intention of exporting them.

76. AIR 1953 SC 333.
77. AIR 1958 SC 1002.
It is only the sale under which the export is made, that is exempt and a purchase which precedes such a sale does not fall within the purview of Article 286(1)(b) though made for the purpose of or with a view to effecting an export.\(^78\)

(iv) **Goods of Special Importance**

Article 286(3) empowers Parliament to declare certain goods to be of special importance in inter-State trade or commerce and in relation to such goods, to lay down the restrictions and conditions subject to which any State law may regulate the levy of tax on their sales or purchases. In exercise of the power, Parliament has by Section 14 of the Central Sales Tax Act, 1956 declared certain goods of special importance in inter-State trade and commerce. The restrictions on taxation of sales of such goods as imposed by Section 15 of the Act 1956 are: a tax shall be levied only on the last sale or purchase inside the State; it shall be levied only at one stage; and at a maximum rate of 3 per cent of the sale price of the commodity.

(v) **Immunity From Mutual Taxation**

For the smooth working of the system of double government set up by a federal Constitution, it is necessary that there should be immunity of the property of one government from taxation by another. It has been generally agreed that "mutual immunity from taxation would save a good deal of fruitless labour in assessment and calculation and cross-accounting of taxes between the two governments."\(^79\) This "mutual immunity from taxation" is the most significant application of the general principle of 'immunity of instrumentalities' or 'inter-governmental immunity' which seeks to ensure that government at one level in a federation operates without unduly restricting the operations


The doctrine of immunity was for the first time propounded by the Supreme Court of the United States of America in the well-known case of *McCulloch v. Maryland*, to mean that "when two separate Governments are established as in a Federal Constitution, each with a limited jurisdiction, the power of each Government shall be construed as being under an implied limitation that it shall be so exercised as not to impair the functions allotted to the other Government". So expounding the doctrine, the Court laid down that the States had no power, by taxation or otherwise to "retard, impede, burden or in any matter control, the operations of the constitutional law enacted by Congress to carry into execution the powers vested in the general government."

Applying the same principle on a reciprocal basis to protect the State instrumentalities from Central taxation, the Supreme Court held in *Collector v. Day* that the Central Government could not tax the income of a State judicial official. This doctrine of immunity has had many vicissitudes of fortune in the decisions of the courts in America, where subsequently, the Supreme Court tended to limit its scope. The present position of the 'immunity doctrine' there may be summed up as follows: "A discriminatory tax by one government on the activities of the other is invalid. A federal non-discriminatory levy imposing a substantial burden on the States, or interfering with the performance of their 'essential' or 'sovereign' functions is also bad. A State function is not immunized from Central taxation if the burden will be absorbed by private persons." Business activities carried on by the States, can be

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80. Dr. Jain, 290.
81. (1819) 4 Wheaton, 316. In this case the U.S. Congress enacted a law incorporating a Bank and a State levied a tax on the operations of the Bank. The Court held the levy unconstitutional.
82. (1870) 11 Wall 113.
83. The Constitution, there, contains no express provision regulating the mutual immunity, judicial decisions have therefore hold the field.
subjected to Central taxes'. The immunity to the States has, thus, come to be confined to function of a governmental character. As regards Central instrumentalities, the Congress can always confer immunity on any of them from State taxation under the 'necessary and proper clause'.

In Canada, the Courts, profiting from the American experience, have given a very limited recognition to the doctrine. Section 125 of the British North America Act 1867 expressly incorporates the principle of inter-governmental immunity, insofar as, it prohibits taxation of lands or property of one government by the other. Though the provision formulates the rule of immunity of the Dominion as well as the Provinces of the mutual taxation, the section has been mostly applied to prevent the Provinces from taxing Dominion property. Therefore, it does not immunize Provincial imports of goods from Central customs duties. A tax may be levied on an owner of land leased to the Crown or on a tenant of government land. The immunity has, also, been refused to the income of officials of one government from being taxed by another government. No tax can, however, be levied on a corporate body for occupying land when it is a servant or an agent of the Crown. Also, discriminatory taxes by one government against another cannot be levied.

The Constitution of Australia, has made a formal provision for a restricted form of mutual immunity. Section 114...

86. Section 125 says: "No lands or property belonging to Canada or any province shall be liable to taxation."
88. Spooner Oil Ltd. & Spooner v. Tayner Valley Gas Conservation Board, (1933), SCR 629 (Can).
of the Commonwealth of Australia Act 1900 lays down, "A State shall not without the consent of the Parliament of the Commonwealth... impose any tax on property of any kind belonging to the Commonwealth, nor shall the Commonwealth impose any tax on property of any kind belonging to a State." The Australian High Court pointed out that this provision only refers to 'tax on property' and that the prohibition contained in it is different from the implied prohibition underlying the doctrine of immunity of instrumentalities. Therefore in the early days of the Commonwealth, in respect of inter-governmental taxation, not covered by Section 114, the Court applied the doctrine as laid down by the Chief Justice Marshall in 1819. The doctrine held its ground till the decision in Engineers' Case in 1920, where the Court disapproved the reciprocal application of the doctrine of non-interference. The question of the relations of the Commonwealth and the States in the matter of taxation was considered by the Court in the First Uniform Tax case and the Second Uniform Tax Case. The Court rejected the doctrine of immunity and pointed out that it had almost been entirely abandoned. However, the Court has held that discriminatory laws cannot be made by one government against the other. Further that it was a necessary consequence of the system of government established by the Constitution that the States could not tax the Commonwealth in respect of anything done in the exercise of its powers and functions. The Constitutional provision contained in Section 114 is confined to taxes on the

95. West v. Commr. of Taxation, (1937) 56 CLR 657.
holding or ownership of property and does not include taxes on dealings with property. 97 With the result, customs duty does not fall under this provision as it is a tax on the act of import and not on the property. 98

The framers of the Indian Constitution had the advantage of knowing the history of these developments in the other federations and also the historical background in India and the provisions in the Government of India Act 1935 dealing with the question. Earlier to the Act 1935, a distinction was made between the trading and business activities of a Government and its governmental activities, the former were subjected to taxation while the latter were to remain immune from it. 99 Based on this distinction, Section 2 of the Government Trading Taxation Act 1926 made liable trade or business and all operations connected therewith and all goods owned in British India for the purposes thereof and all income arising in connection therewith by or on behalf of the Government of any part of His Majesty's Dominions exclusive of British India to income tax and all other taxation in the same manner as in like cases and other person would be liable. This distinction between the business and trading activities and governmental activities carried on by a Government finds a place in the Government of India Act 1935. Section 154 of the Act exempted property of the Central Government from Provincial or local taxation while Section 155 immuned from Central taxation the lands or buildings or income accruing, arising or received in India by the Government of a Province.

The Indian Constitution incorporates provisions regarding the inter-governmental tax immunities mainly in Article 285, and 289, which have adopted the pattern of the Government of India Act 1935, in the matter. Article 285 de bars a State from taxing Union property. Article 289 which is a corresponding

97. Ibid.
98. Ibid.
provision in favour of the States confers a limited immunity from Union taxation on the States. It lays down that "the property and income of a State shall be exempted from Union taxation". However, in Clause (2) of this Article, it is provided that no such immunity applies to a trade or business carried on by or on behalf of the Government of a State or any property used or occupied for the purposes of any such trade or business, or any income accruing or arising in connection therewith. Clause (3) of the Article empowers the Parliament to declare any class of trade or business to be incidental to the ordinary functions of Government which would be exempt from Union taxation. Article 285 and 289 thus put the Union and the States on a different footings, viz., whereas Union property devoted to commercial functions is exempt from State taxation, such State property is not so exempt from Union taxation. It may, however, be noticed that the provisions of Articles 285 and 289 are similar to Section 125 of the British North America Act 1867 and Section 114 of the Commonwealth of Australia Constitution Act 1900.1

The provision of Article 289 evoked considerable controversy in 1962 which was resolved only by a Presidential reference made to the Supreme Court under Article 143 of the Constitution.2 In 1962, the Union Government proposed to amend the Sea Customs Act 1878 and the Central Excise and Salt Act 1944, so as to enable it to levy customs duties on goods imported by the State or excise duties on goods other than salt, produced or manufactured by the States, even when the goods were imported or produced or manufactured by the States for governmental purposes. The States raised the contention that the proposed amendments would be unconstitutional. The question raised by the reference related to the true construction of Article 289. The Supreme Court held by a majority that the Centre can levy customs duty on goods

1. See supra.
2. In Re Sea Customs Act, AIR 1963 SC 1760.
imported or exported or an excise duty on goods produced or manufactured, by a State Government irrespective of whether or not it is used for purposes of trade or business. To exempt the exports or imports made by a State from customs duty would, in their opinion, seriously impair the power of Parliament to regulate foreign trade by using its taxing powers. Similarly, exempting manufacture or production of goods by a State from Central taxation would adversely affect the Central power to regulate inter-State commerce. Article 289, the Supreme Court observed, bars Central taxes directly on property or income of the States and not those taxes which may indirectly affect or are in respect of income or property. The customs duty is a tax on 'import or export' and excise on 'production or manufacture' and none of these taxes is on property as such. In support of their answer, the Court said that the Center was under an obligation to share its revenue with the States and therefore, its revenue raising capacity should not be impaired by interpreting the exemption in favour of the States broadly. The Court pointed out that "the general outline of Article 289 is based upon the American pattern that the property and income are not to be taxed, that trading is not an ordinary function of the Government though Parliament may by law declares that any trade or business or any class of trade or business is incidental to functions of Government." There is no immunity in respect of the agents or instrumentalities of Government in our Constitution. As far as the instrumentalities, the Supreme Court in another significant pronouncement, declared: "It was futile to attempt the resuscitation of the now exploded doctrine of the immunity of instrumentalities which, originating from the observations of Marshall, C.J. in *McCulloch v. Maryland*, has been decisively rejected by the Privy Council as inapplicable to the interpretation of the respective powers of the State and the Centre under the Canadian and Australian Constitutions... and

3. Ibid.
has practically been given up even in the United States."

The Supreme Court in India has thus rightly rejected the extension of the doctrine of immunity of instrumentalities beyond what is envisaged by the Constitution. The doctrine stands discredited even in the country of its origin and has been rejected in Canada and Australia. The principle of mutual immunity is good so long the function of the Government are circumscribed within a narrow province of order and defence. But complexities inevitably arise when the functions expand under the influence of the 'Welfare State' ideal and the government pursues an active policy of nationalisation of industries or increasingly enters the fields of industrial and commercial activities. Under such circumstances, any rigid adherence to the principle, is not possible. The merit of the Indian Constitution is that it accepts the doctrine to the extent that it is practicable while expressly providing for the Parliament to extend its operation under special circumstances. The Constitution-makers thus did not take a doctrinaire view but were influenced by realistic consideration and by not providing for complete mutual exemption from taxation they ensured that India would be spared of those problems which arose in the United States and Australia which compelled them to modify the original rigid nature of the doctrine of reciprocal immunity.6