CASE NO.:
Appeal (civil) 3453 of 2002

PETITIONER:
JINDAL STRIPE LTD. AND ORS.

RESPONDENT:
STATE OF HARYANA AND ORS.

DATE OF JUDGMENT: 26/09/2003

BENCH:
RUMA PAL & P. VENKATRAMA REDDY

JUDGMENT:
JUDGMENT

2003 Supp(4) SCR 154

The following Order of the Court was delivered : Leave granted in special leave petitions.

In this batch of appeals, the constitutional validity of the Haryana Local Area Development Tax Act, 2000 has been challenged primarily on two grounds, first: that the Act is violative of Article 301 of the Constitution and is not saved by Article 304 and second: that the Act in fact seeks to levy sales tax on inter-state sales, which is outside the competence of the State Legislature.

After we had been addressed at length on the first of these issues by both sides, we were of the view, and the counsel for the appearing parties also submitted, that the question needed to be referred to a larger Bench under Article 145(3) of the Constitution. Arguments on the second issue were, therefore, not concluded and will be necessary only if the first issue is decided against the appellants.

The factual background in which the issues are raised is briefly stated. The appellants are all industries or associations of industries manufacturing their products within the State of Haryana. The raw material for their respective products is purchased from outside the State. Most of the finished products are sent to other states on stock transfer or on consignment basis. It is the admitted position that sales tax both on the 'import of the raw material and on the 'export' of finished products is not payable nor paid by the appellants to the State of Haryana.

The Act came into force w.e.f. 5th May 2000 "to provide for levy and collection of tax on the entry of goods into the local areas of the State of Haryana for consumption for use therein and matters incidental thereto and connected therewith". In 2001 the Preamble has been amended. The object of the Act now reads "to provide for levy and collection of tax on the entry into a local area of the State of Haryana, of a motor vehicle for use or sale, and of other goods for use or consumption, therein and matters incidental thereto and connected therewith". We do not consider it appropriate to discuss the various provisions of the Act which have been analyzed by the parties before us but only highlight the aspects of the Act which, in our opinion, are relevant for the purpose of this reference under Article 145(3).

The Act seeks to impose entry tax on all goods brought into a "local area". The phrase 'local area' has been defined in Section 2(14) of the Act as meaning :

"an area within the limits of a Municipal corporation established under the Haryana Municipal Corporation Act, 1994 (Haryana Act 16 of 1994), or a municipality established under the Haryana Municipal Act, 1973 (Haryana Act

24 of 1973), or a Town Board or a Cantonment Board established under the Cantonment Act, 1924 (Central Act 2 of 1924), or a Zila Parishad established under the Haryana Panchayati Raj Act, 1994 (Haryana Act No. 11 of 1994), or any other local authority constituted or continued under any law for the time being in force".

The entire State is divided into local areas. The Act ostensibly covers not only vehicles bringing goods into the state but also vehicles carrying goods from one local area to another. However, those who pay sales tax to the State are exempted from payment of the entry tax. Ultimately the entry tax only falls on concerns like the appellants which, by virtue of the provisions of the Central Sales Tax Act, 1956, pay sales tax on the purchase of raw material and sale of finished goods to other States and do not pay sales tax to the State of Haryana. Under section 22 of the Haryana Act, "The tax collected under this Act shall be distributed by the State Government amongst the local bodies to be utilised for the development of local areas". This, shortly put, is the context in which the challenge to the Act under Article 301 has been made.

Article 301 of the Constitution which guarantees freedom of trade, commerce and intercourse says :

"Subject to the other provisions of this Part, trade, commerce and intercourse throughout the territory of India shall be free".

In Atiabari Tea Co. Ltd v. State of Assam. [1996] 1 SCR 809. it was held that taxing laws are not excluded from the operation of Article 301; which means that tax laws can and do amount to restrictions on the freedoms guaranteed to trade under Part XIII of the Constitution. However the prohibition of restrictions on free trade is not an absolute one. Statutes restrictive of trade can avoid invalidation if they comply with Article 304

(a) or (b) In Atiabari Tea it is was held that only such taxes as directly and immediately restrict trade would fail within the purview of Article 301 and that, any restriction in the form of taxes imposed on the carriage of goods or their movement by the State Legislature can only be done after satisfying the requirements of Article 304(b). The Statute which was challenged in Atiabari Tea was the Assam Taxation (on goods carried by Roads and Inland Waterways) Act, 1954. It was held that the Act had put a direct restriction on the freedom of trade and since the State Legislature had not complied with the provisions of Article 304(b), it was declared void Similarly, the Act which is impugned before us imposes a restriction on trade and would fall foul of Article 301, particularly when the provisions of Article 304(b) have not been adhered to.

However, an exception to Article 301 and its operation was judicially crafted in Automobile Transport (Rajasthan) Ltd. v. State of Rajasthan, [1962] 1 SCR 491. The challenge in that case was to the Rajasthan Motor Vehicles Taxation Act, 1951. The challenge under Article 301 was rejected by the Constitution Bench by holding that "the taxes are compensatory taxes which instead of hindering trade, commerce and intercourse facilitate them by providing and maintaining the roads". The following observation at paragraph 21 of the report also merit attention :

"If a statute fixes a charge for a convenience or service provided by State or an agency of the State and imposes it upon those who choose to avail themselves of the service or convenience, the freedom of trade and commerce may well be considered unimpaired."

Art 304(a) impose on goods imported from other States [or the Union territories] any tax to which similar goods manufactured or produced in that State are subject, so. however, as not to discriminate between goods so imported and goods so manufactured or produced, and b) impose such reasonable restrictions on the freedom of trade, commerce or intercourse

with or within that State as may be required in the public interest :

Thus the concept of "compensatory taxes'" was propounded. Therefore taxes which would otherwise interfere with the unfettered freedoms under Article 301 will be protected from the vice of unconstitutionality if they are compensatory. The question therefore is. is the Act impugned in the present case compensatory?

In Automobile Transport, it was said :

".....a working test for deciding whether a tax is compensatory or not is to enquire whether the trades people are having the use of certain facilities for the better conduct of their business and pining no! patently much more than what is required for providing the facilites. "

(Emphasis added)

Right from 1962 upto 1995, this working test was applied by this Court only in relation to Motor Vehicles Taxes for deciding Whether it was compensatory or not. The decisions proceeded on the principle adumbrated m Automobile Transport which Was paraphrased by Mathew, J speaking for a Bench of three Judges in G. K. Krishnan v. State of Tamil Nadu, [1975] 1 SCC 375 that "the very idea of compensatory tax is service more or less commensurate with the tax levied". As the operation of motor vehicles has direct relation to the use of roads/bridges, the statistics relating to receipts and expenditure for constructing road and bridges for some years were considered in each case in order to judge whether the tax was not patently more than what was required to provide the facility, and therefore compensatory. [See : Shaik Madar Saheb & Ors. v. The State of Adhra Pradesh. [1972] 4 SCC 635; Bolani Ores Ltd v. State of Orissa, [1974] 2 SCC 777; G.K. Krishnan v. State of Tamil Nadu, [1975] 1,SCC 375; M/s. International Tourist Corporation y, Stale of Haryana, [1981] 2 SCC 318; Malwa Bus Service (P) Ltd. v. Stale of Punjab, [1983] 3 SCC 237; Mrs. Meenakshi v. State of Karnataka, AIR (1983) SC 1283; B. A. Jayaram v. Union of India [1984] 1 SCC 168 and State of Maharashtra v. Madhukar Balkrishna Badiya,[l988]4 SCC 290.

The only case cited at the bar dealing with tax other than motor vehicles tax during the aforementioned period is the case of Kamalit Singh v. Municipal Board, [1986] 4 SCC 174. In that case the toll tax levied under the U.P. Municipalities Act on vehicles and other conveyances entering the Municipal limits was tested from the standpoint of Article 301. It was held that the tax cannot be treated to be compensatory tax for the reason that the Municipal Board provided no facilities whatever to the owners of vehicles like State carriages making use of national highway in question.

The following propositions are deducible from these cases :

1) The essence of article 301 is a right of free movement of trade without any obstructions by way of barriers - inter-state or intra-state or impediments operating as such barriers. Taxes which have a direct impact on the flow of trade and commerce constitute a violation of Article 301 unless the legislation is brought within the scope of Article 304(b).

2) The tax levied upon the entry of goods into a local area for the purpose of use, consumption or sale therein has a direct effect on the movement of goods and therefore it can be saved only if the levy is in the nature of compensatory tax for the use of trading facilities or it comes under the protective umbrella of Article 304.

3) So long as a tax remains compensatory or regulatory, it cannot operate as a hindrance to trade. Regulatory measures or compensatory taxes imposed to provide facilities and services to traders do not affect the freedom contemplated by Article 301 and such measure/taxes need not comply with the requirements of Article 304.

4) Tax imposed for augmenting general revenues of the State such as Sales Tax, is not compensatory. However, Motor Vehicles Tax is a typical instance of compensatory tax because, in substance, it is a tax imposed for the use of roads in the State and the tax enables the State to provide and maintain roads.

5) It is of the essence of compensatory tax that the service rendered or facility provided should be more or less commensurate with the tax levied.

6) A tax does not cease to be compensatory in nature merely because the precise or specific amount collected is not actually used in providing the facilities. However, the existence of a specific, identifiable object behind the levy and a nexus between the subject and the object of the levy is necessary to uphold a regulatory and compensatory tax.

7) The expenditure for providing the facilities may be met from other sources.

8) The actual user of the facility pay the tradesmen who are subject to the tax is immaterial.

Apart from these principles, the appellants have urged additional grounds for holding that the impugned Act is not compensatory. It has been submitted that (1) A taxation measure which seeks to impose tax only on a section or a class of traders and exclude substantial section of the traders cannot be called compensatory tax. Uniformity in the incidence of taxation so as to bring all the traders who use the facility within the net of taxation is an essential attribute of compensatory tax, (2) Tax imposed on ad valorem basis can never be compensatory tax, and (3) if an amenity or service is already taxed under other laws, the tax in question cannot be regarded as compensatory.

Another question of importance which needs an answer to decide the controversy in the case on hand is whether the compensatory nature of tax should be self-evident from the taxing law itself or could it be judged from the manner in which the tax revenue is utilized in course of time?

In 1995, some of the principles set out supra appear to have been deviated from when the principle of compensatory tax was applied to entry tax in Bhagat Ram v. Commissioner of Sales Tax, [1995] 1 SCC 673 which was decided by a Bench of three Judges.

In Bhagat Ram v. Commissioner of Sales Tax (supra), the subject matter of challenge was the M.P. Sthaniya Kshetra Me Mal Ke Pravesh Par Kar Adhiniyam, (1976). In that case, although it was demonstrated by the appellant-State and not disputed by the respondents that the levy was compensatory nevertheless the court went on to say :

"The submission of Shri Ashok Sen, learned senior counsel that compensation is that which facilitates the trade only does not appear to be sound. The concept of compensatory nature of tax has been widened and if there is substantial or even some link between the tax and the facilities extended to such dealers directly or indirectly the levy cannot be impugned as invalid. The stand of the State that the revenue earned is being made over to the local bodies to compensate them for the loss caused, makes the impost compensatory in nature, as augmentation of their finance would enable them to provide municipal services more efficiently, which would help or ease free flow of trade and commerce, because of which the impost has to be regarded as compensatory in nature, in view of what has been stated in the aforesaid decisions, more particularly in Hansa Corpn. Case."

The reference to State of Karnataka v. Hansa Corporation, [1980] 1 SCC 697 by the Court was inapposite. In Hansa’s case although the challenge was to the levy of entry tax, the issue whether the tax was compensatory in nature

was expressly left open. This is what the Court had said :

"The State did not attempt in the High Court to sustain the validity of the impugned tax law on the submission that it was compensatory in character. No attempt was made to establish that the dealers in scheduled goods in a local area would be availing of municipal services and municipal services can be efficiently rendered if the municipality charged with a duty to render services has enough and adequate funds and that the impugned tax was a measure for compensating the municipalities for the loss of revenue or for augmenting its finances. As such a stand was not taken, it is not necessary for us to examine whether the tax is compensatory in character "

In fact the impugned Act was saved because Article 304 had been complied with. It was for that reason alone that the Act could not be struck down on the ground that it was violative of Article 301. We find nothing in Hansa Corpn. 's case which seems to support the proposition enunciated in the passage quoted above.

The dicta in Bhagat Ram's case (supra) was relied on by a Bench of two Judges in the case of State of Bihar v. Bihar Chamber of Commerce, [1966] 9 SCC 136 which reiterated the position that "some-connection" between the tax and the trading facilities is sufficient to characterize it as compensatory tax. The Court went further and took judicial notice of the fact that the State provides several facilities to the trade such as laying and maintenance of roads, waterways, markets etc.. and on this premise, held that the entry tax was compensatory in nature. The learned Judges did not consider it necessary to insist on the State coming forward with the details of facilities provided to the traders and the expenditure incurred or incurrable thereafter. Even though the Act was upheld on an independent ground i.e. compliance with Article 304(b), nevertheless the characterization of the Act impugned in that case as compensatory and the reasoning adopted for that conclusion cannot be brushed aside as mere obiter dicta.

It is contended by the appellants, with considerable force, that if the concept of compensatory tax has to be understood in the manner in which it has been viewed by the Court in the decisions of Bhagat Ram and Bihar Chamber of Commerce, there will be no practical distinction between a tax raised for general revenue purposes and a compensatory tax meant for the specific purpose of providing facilities or services to the persons subjected to the tax. All State revenues are presumably expended or at least are expendible only for the welfare of the nation or the State as a whole. This may result in a general economic upliftment and the betterment of all facets of life including ultimately and in an indirect sense the trading community. The approach in the two decisions noted does away with the difference between taxes in general and compensatory taxes. If that is the law then any tax could pass the test of compensatory tax judged from the standard applied. Then no tax can impinge on the freedom ordained by Article 301, a result which, it is pointed out, would go counter to the Court's decision in Atiabari Tea and the long line of authorities referred to earlier starting with the Automobile Transport case.

In the present case, Section 22 which we have quoted earlier, says that the tax shall be given to local bodies for utilization for the development of local areas. There is nothing in Section 22 to indicate that the "development of local area" means development of roads or other trading facilities. It is argued by the appellants that the tax levied on the appellants could in fact be used purely for 'non trading facilities' such as setting up schools, hospitals, housing etc. No attempt has been made by the respondents in any of the special appeals to produce figures to show a nexus between the levy collected and any service or facility rendered or to be rendered. But the High Court rejected the challenge to the Haryana Act on the basis of the aforesaid observation in Bihar Chamber of Commerce.

To sum up : the pre-1995 decisions held that an exaction to reimburse/

recompense the State the cost of an existing facility made available to the traders or the cost of a specific facility planned to be provided to the traders is compensatory tax and that it is implicit in such a levy that it must, more or less, be commensurate with the cost of the service or facility. The decisions emphasised that the imposition of tax must be with the definite purpose of meeting the expenses on account of providing or adding to the trading facilities either immediately or in future provided the quantum of tax sought to be generated is based on a reasonable relation to the actual or projected expenditure on the cost of the service or facility.

The decisions in Bhagat Ram and Bihar Chamber of Commerce now say that even if the purpose of imposition of the tax is not merely to confer a special advantage on the traders but to benefit the public in general including the traders, that levy can still be considered to be compensatory. According to this view, an indirect or incidental benefit to traders by reason of stepping up the developmental activities in various local areas of the State can be legitimately brought within the concept of compensatory tax, the nexus between the tax known as compensatory tax and trading facilities not being necessarily either direct or specific.

Since the concept of compensatory tax has been judicially evolved as an exception to the provisions of Article 301 and as the parameters of this judicial concept are blurred particularly by reason of the decisions in Bhagat Ram (supra) and Bihar Chamber of Commerce (supra). We are of the view that the interpretation of Article 301 vis-a-vis compensatory tax should be authoritatively laid down with certitude by the Constitution Bench under Article 145(3).

In the circumstances let all these matters be placed before the Hon’ble Chief Justice for appropriate directions.