

# ENTRY TAX: IS IT CONSTITUTIONAL?

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## [Abstract]

*The comment is an attempt to shed light on Article 304(b) of the Constitution and the nature of entry tax levied by States. The author has primarily tried to find the solutions of the questions referred to a Constitution Bench by the Supreme Court in the precise question which the comment seeks to provide answer to the question as to whether entry tax levied by States could be considered to be violative of the freedom conferred by Article 301 of the Constitution.*

## [Introduction]

The Supreme Court in *Jindal Stainless Ltd. v. State of Haryana*<sup>2</sup> has observed that Part XIII of the Constitution is an amalgam of the United States and Australian Constitutions as Article 301 is inspired by Section 92 of the Australian Constitution while Articles 302, 303 and 304 are borrowed from the commerce clause under Article 1 of the US Constitution.<sup>3</sup> The interpretation of the provisions of the Part XIII of the Constitution has been a *quaestiones vexatae* of our constitutional law.

The author is of the opinion that the questions referred to a five-judge Bench of the Supreme Court in *Jaiprakash Associates Ltd. v. State of Madhya Pradesh*<sup>4</sup> could be analyzed.

There are few questions that have been referred to the Constitution Bench.

*I) Whether the State enactments relating to levy of Entry Tax have to be tested with reference to both clauses (a) and (b) of Article 304 of the Constitution for determining their validity and whether clause (a) of Article 304 is conjunctive with or separate from clause (b) of Article 304?*

The use of the word 'and' between clauses (a) and (b) of Article 304 gives the impression that the clause (a) of Article 304 is conjunctive with clause (b) of Article 304 but this is just symptomatic of bad draftsmanship of Part XIII of the Constitution. Furthermore, Article 304(b) is the State analogue of Article 302 of the Constitution with a few changes and is separate from Article 304(a). Thus any State enactment relating to the levy of Entry Tax has to be tested with reference to Article 304(b) of the Constitution.

*II) Whether imposition of Entry Tax levied in terms of Entry 52 List II of 7<sup>th</sup> Schedule is violative of Article 301 of the Constitution? If the answer is in the affirmative whether such levy can be protected if Entry Tax is compensatory in character and if the answer to the aforesaid question is in the affirmative what are the yardsticks to be applied to determine the compensatory character of the Entry Tax.*

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<sup>2</sup> AIR 2006 SC 2550.

<sup>3</sup> S.H. Kapadia, Ruma Pal, B.N. Srikrishna, Tarun Chatterjee and P.P. Naolekar, JJ. in *Jindal Stainless Ltd. v. State of Haryana*, AIR 2006 SC 2550, ¶ 29.

<sup>4</sup> 2008 (16) SCALE 90.

The imposition of Entry Tax levied in terms of Entry 52 List II of 7<sup>th</sup> Schedule is clearly violative of the freedom of trade, commerce and intercourse guaranteed by Article 301 of the Constitution. Any such levy can be protected if the Tax is compensatory in character. The yardsticks to be applied in determining the compensatory character of the Entry Tax would be the same as applied by the Court in *Automobile Transport Limited* and reiterated in *Jindal Stainless Ltd.* in 2006. The decision of the Court in *Automobile Transport Limited* strengthened the position of States as far as collection of vehicle taxes were concerned. The Court, while stressing on the freedom guaranteed under Article 301, created the edifice of compensatory tax which would not attract the prohibition contained in Article 301 as it would be a tax whose quantum is approximately equal to the benefit conferred on trade as a result of the tax. The subsequent decisions of the Court did not stick to this fundamental principle of proportionality evolved in *Automobile Transport Limited* and diluted it to a great extent by resorting to an interpretation which leaned grossly in favour of the States. The Court has set this anomaly right in *Jindal Stainless Ltd.* and has again reiterated the principle of proportionality evolved in *Automobile Transport Limited*. Thus the levy of Entry Tax will also have to satisfy the principle of proportionality which implies that its quantum should be approximately equal to the benefit conferred on trade as a result of the tax.

III) *Whether Entry 52, List II, 7th Schedule of the Constitution like other taxing entries in the Schedule, merely provides a taxing field for exercising the power to levy and whether collection of Entry tax which ordinarily would be credited to the Consolidated Fund of the State being a revenue received by the Government of the State and would have to be appropriated in accordance with law and for the purposes and in the manner provided in the Constitution as per Article 266 and there is nothing express or explicit in Entry 52, List II, 7th Schedule which would compel the State to spend the tax collected within the local area in which it was collected?*

The answer to the third question could be found in the opinion of the Court in *Jindal Steel Ltd.* The Court in *Jindal Steel Ltd.* observed,

*“The primary purpose of a taxing statute is the collection of revenue. On the other hand, regulation extends to administrative acts which produces regulative effects on trade and commerce.”*

The Court has also observed,

*“When the tax is imposed as a part of regulation or as part of regulatory measure, its basis shifts from the concept of “burden” to the concept of measurable/quantifiable benefit and then it becomes a “compensatory tax” and its payment is then not for revenue but as reimbursement/recompense to the service/facility provider.”*

The burden is always on the State to prove that the payment of compensatory tax is a reimbursement/recompense for the quantifiable/measurable benefit provided or to be provided to its payers. The Court has also stressed on the fact that while a compensatory tax may incidentally bring in net revenue to the government but that circumstance is not an essential ingredient of compensatory tax. Thus, it is clear that even if Entry 52 of VII Schedule does not specifically requires the State to spend the money collected in that local area, still any compensatory tax cannot be a device of revenue collection for the State and it has to necessarily provide some quantifiable/measurable benefit to its payers.

IV) *Will the principles of quid pro quo relevant to a fee apply in the matter of taxes imposed under Part XIII?*

The answer to this question is to be found in the opinion of the Court in *Jindal Steel Ltd* wherein it has clearly elaborated the conceptual distinction between a compensatory tax and a fee. While principle of burden (capacity to pay) governs a tax, fee is governed by the principle of equivalence (exaction should approximate the benefit flowing from the exaction). The Supreme Court in *International Tourist Corporation v. State of Haryana*<sup>5</sup> had stated that a compensatory tax need not approximate benefit as it would render it indistinguishable from a fee. The Court in *Jindal Steel Ltd*. has corrected this proposition and has considered that compensatory tax is a species of fee with the difference that a compensatory tax is levied on an individual as a member of class, while a fee is levied on an individual as such. V. Niranjan, in an insightful analysis of the decision of the Court in *Jindal Steel Ltd.*, has observed,

*“A fee is ‘compensatory’ if that particular fee improves the flow of trade, and if so, it will be outside the purview of Article 301. But that does not make it a compensatory tax, because a fee is not a tax in the first place. In other words, equivalence is a necessary but not sufficient condition for a levy to be considered a fee. A tax is generally not compensatory. However, that does not mean that a tax which is compensatory becomes a fee. It continues to be a compensatory tax, and is outside the purview of Article 301 for that reason. A fee, on the other hand, usually has elements of quid pro quo, but will not be ‘compensatory’ unless it improves trade. Thus, the test, after Jindal, is exactly the same test as after Automobile - does the levy benefit trade to approximately the same extent as the quantum of its exaction?”*<sup>6</sup>

This makes two propositions clear. While a compensatory tax could be species of fee but conceptually they are very different from each other. First, a fee would be compensatory if it improves the flow of trade but that does not make it a compensatory tax. Second, a tax which is compensatory does not become a fee. So we can conclude that despite the lingering doubt over the question whether *quid pro quo* remains an integral feature of a fee<sup>7</sup>, the principles of *quid pro quo* relevant to a fee apply in the matter of taxes imposed under Part XIII, despite the fact that conceptually a compensatory tax cannot be equated to a fee.

V) *Whether the Entry Tax may be levied at all where the goods meant for being sold, used or consumed come to rest (standstill) after the movement of the goods ceases in the ‘local area’?*

The Supreme Court in *Atiabari Tea Company Limited* had come to the conclusion that the freedom provided by Article 301 of the Constitution is related only to the movement part of the trade. This conception of the kind of freedom enshrined in Article 301 is very different from what might have been conceived by Shah J in *Atiabari Tea Company Limited*. Thus the Entry Tax cannot be levied at all where the goods meant for being sold, used or consumed come to rest after the movement of the goods ceases in the ‘local area’.

VI) *Whether the Entry Tax can be termed a tax on the movement of goods when there is no bar to the entry of goods at the State border or when it passes through a local area within which they are not sold, used or consumed?*

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<sup>5</sup> (1981) 2 SCC 318.

<sup>6</sup> V. Niranjan, *Interstate Trade and Commerce: The Doctrine of Proportionality Reaffirmed*, 2 Ind. J. Const. L. 201 (2008).

<sup>7</sup> See *Vijaylakshmi Rice Mill v. CTO*, AIR 2006 SC 2987, per Katju J.

An analysis of the decisions of the Court reflects that the device of compensatory tax enables the State to override the freedom guaranteed under Article 301 of the Constitution. Thus when there is no bar to the entry of goods at the State border then the Entry Tax cannot be termed as a tax on the movement of goods, but it cannot be extended to mean that no Entry Tax could be levied when the goods pass through a local area within which they are not sold, used or consumed.

*VII) Whether interpretation of Articles 301 to 304 in the context of tax on vehicles cases in Atiabari case and Automobile case apply to Entry Tax cases and if so, to what extent.*

The interpretation of Articles 301 to 304 in the Atiabari and the Automobile cases has to apply to Entry Tax cases in every possible manner. The test of proportionality as devised by the Court in these two cases, and further reiterated in *Jindal Steel Ltd.*, is the test that has to be applied to the Entry Tax cases too.

*VIII) Whether the non discriminatory indirect State Tax which is capable of being passed on and has been passed on by traders to the consumers infringes Article 301 of the Constitution?*

The non-discriminatory indirect Entry Tax, if challenged as being excessive, will have to comply with the conditions mentioned in Article 304(b) only if the incidence of the tax is not passed on by the traders to the consumers. In fact that State levying Entry Tax should ensure that traders are not able to pass on the incidence of the tax onto the consumers.

*IX) Whether a tax on goods within the State which directly impedes the trade and thus violates Article 301 of the Constitution can be saved by reference to Article 304 of the Constitution alone or can be saved by any other Article?*

Any tax on goods within the State which directly impedes the trade, by being excessive in nature, and thus violates Article 301 of the Constitution can be saved by reference to Article 304(b) of the Constitution. The observation of D.D. Basu, quoted earlier in the paper, clearly supports such a view.

*X) Whether a levy under Entry 52, List II, even if held to be in the nature of a compensatory levy, it must, on the principle of equivalence demonstrate that the value of the quantifiable benefit is represented by the costs incurred in procuring the facility/services (which costs in turn become the basis of re- imbursement/recompense for the provider of the services/facilities) to be provided in the concerned 'local area' and whether the entire State or a part thereof can be comprehended as local area for the purpose of Entry Tax?*

The judgment of the Court in *Jindal Steel Ltd.* indicates that the entire State can be comprehended as local area for the purpose of Entry Tax. The only requirement is that the State should be able to adduce quantifiable data which supports the argument that the levy is compensatory in nature. The Court has observed in *Jindal Steel Ltd.*,

*Applying the above tests/parameters, whenever a law is impugned as violative of Article 301 of the Constitution, the Court has to see whether the impugned enactment facially or patently indicates quantifiable data on the basis of which the compensatory tax is sought to be levied. The Act must facially indicate the benefit which is quantifiable or measurable. It must broadly indicate proportionality to the quantifiable benefit. If the provisions are ambiguous or even if the Act does not indicate facially the quantifiable benefit, the burden will be on the State as a service/facility provider to show by placing the material before the Court, that the payment of compensatory tax is a reimbursement/recompense for the quantifiable/ measurable benefit provided or to be provided to its payer(s). As soon as it is shown*

*that the Act invades freedom of trade it is necessary to enquire whether the State has proved that the restrictions imposed by it by way of taxation are reasonable and in public interest within the meaning of Article 304(b) [See: para 35 of the decision in the case of Khyerbari Tea Co. Ltd. & Anr. v. State of Assam & Ors., reported in AIR 1964 SC 925].*

After the decision of this case, no other SC decision on this matter has come up but three HC decisions have definitely set the limelight. In a Karnataka HC decision in *L and T Case Equipment Pvt. Limited represented by its area accountant harish barai vs. state of karnataka by its finance secretary and government of karantaka represented by its finance secretary*<sup>8</sup>, constitutional validity of section 4-b and 4-bb of karnataka tax on entry of goods into local area act, 1979 was challenged<sup>9</sup>. HC held that the tax levied is not a compensatory tax for the use of trading facilities. The tax levied is also not regulatory in nature. The regulation extends to administrative acts which produces regulative effect on trade and commerce. The impugned provisions do not seek to contract conditions under which the activity like trade is to take place. The said provisions are not enacted to enforce discipline or conduct under which the trade has to perform. The tax is not a payment for regulation of conditions or incidents of trade or manufacture. The levy of tax does not facilitate trade. On the contrary it hampers free trade. The primary object of levy of tax is the collection of revenue, as is clear from the object behind the amendment. Therefore, the impugned levy is neither a compensatory tax nor a regulatory measure. The Karnataka Legislature by law, under the impugned provisions of the Act, has not imposed any tax on motor vehicles manufactured or produced on purchase value of a motor vehicle and entry of which is effected into a local area for use or sale therein, within the local area of the State of Karnataka. Under the impugned provision such a tax is levied and collected only in respect of motor vehicle which are brought into a local area from any place outside the State for use or sale therein and who owns the vehicle at the time of entry into a local area. Therefore, the imposition of tax under the Act is discriminatory and hit by Article 304(a) of the Constitution.

Then in *Jaiprakash Associates Limited (Cement Devision) Vs. State of Arunachal Pradesh and Ors.*<sup>10</sup>, it was observed by the HC that as the State had miserably failed to substantiate that the substantial portion of the entry tax collected under the impugned enactment had been spent or is to be spent for providing the facilities to its payers so as to facilitate the trade, by producing materials before the court, HC held the impugned enactment did not satisfy the test laid down for compensatory tax and hence cannot be held to be compensatory in nature.

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<sup>8</sup> (2010) 27 VST 447 (Karn).

<sup>9</sup> HC observed that tax is payable by the importer. The importer is defined to mean a person who brings a motor vehicle into a local area from any place "out side the State" for use or sale therein and who owns the vehicle at the time of its entry into a local area. The words "out side the state" in the definition of importer has created a charge only on the imported vehicles. The goods manufactured or produced within the State are not subjected to any such levy under the Act, as the imported goods. The freedom of trade so declared is against the imposition of barriers or obstructions within the State as well as interstate. All restrictions which directly and immediately affect the movement of trade are declared by article to be ineffective. The only two exceptions under which the Part XIII of the Constitution held to be non applicable is that when such levy of tax is in the nature of compensatory tax or regulatory in character. Therefore, first it is to be found out whether the levy of tax is regulatory in nature or is it a compensatory tax.

<sup>10</sup> (2009) 22 VST 310 (Gauhati).

Further in another recent Guwahati HC decision, *Indian Oil Corporation Ltd. (Guwahati Refinery) Vs. State of Assam and Ors.*,<sup>11</sup> levy of entry tax has been held to be compensatory in nature and hence valid.

### [Conclusion]

With Globalisation, industries require larger markets and as a country we cannot develop, if we try and fragment every state and give liberty to them to levy entry taxes as per their whims and fancies. Obviously States should not resort to such entry taxes for augmenting its revenues. Further Central Government needs to ensure that they do not allow such controversies to rope in the proposed Goods and Service Tax (GST) scenario and they make it clear while implementing Goods and Services Tax (GST) that states cannot levy any entry tax on goods received within the state for consumption, use, or sale therein.

In today's world, Companies need clarity whether a particular levy is applicable or not so that they can accordingly decide on their end pricing to the consumer. As a country, we cannot keep so many Companies/assesseees in lurch. We hope that Supreme Court decides on the constitutional validity of these entry tax acts at the earliest and the Companies/ assesseees are given a clear verdict on the legality of these Entry Tax Acts once and for all.

The decision of the Supreme Court will be eagerly awaited and it has to be seen whether Entry Tax is held to be violative of the freedom guaranteed under Article 301 of the Constitution. Part XIII of the Constitution is replete with *non-obstante* clauses and the presence of exception upon exception in a series of articles has often presented complex questions of interpretation before the Court. There are still several ambiguities in the interpretation of Part XIII which should be settled authoritatively by the Supreme Court. As per the present situation the validity of Entry Tax depends on the nature of the levy i.e., Entry Tax is held valid if it is compensatory or regulatory in nature. In today's world, Companies need clarity whether a particular levy is applicable or not so that they can accordingly decide on their end pricing to the consumer. As a country, we cannot keep so many Companies/assesseees in lurch. We hope that Supreme Court decides on the constitutional validity of these entry tax acts at the earliest and the Companies/ assesseees are given a clear verdict on the legality of these Entry Tax Acts once and for all.

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<sup>11</sup> (2009) 21 VST 76 (Gauhati).