

# Article

## Unconstitutionality of entry tax in West Bengal

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The increasing indirect taxes on goods are impeding the tax burden on the traders of goods in India. The introduction of entry tax in various states, on entry of goods into a state, has acted as adding fuel to fire for the traders and they have been continuously challenging the validity of entry tax through writ petitions in almost every state. The government has always argued its stand by saying that entry tax is a differential tax and non-discriminatory in nature as per Article 304(a) of the Constitution and is compensatory in nature as per Article 304(b) of the constitution. Hence does not violate the provisions of Article 301 of the Constitution of India empowering free trade and commerce in the country. This view has been held valid by various Supreme Court judgments, one of them being the judgment made in case of *Jaika Automobiles Private Limited v State of Maharashtra*.

In a recent ruling of the Calcutta High Court on 24<sup>th</sup> June, 2013, Justice Indira Banerjee has challenged the constitutional validity of entry tax introduced in West Bengal by the State Finance Act, 2012. The order will have serious repercussions on the state's finances - cash-strapped Bengal stands to lose Rs 1,200 crore a year. In the order Justice Indira Banerjee said that the “*West Bengal Tax on Entry of Goods into Local Areas Act, 2012 is unconstitutional because the state Act doesn't have the President's assent*”. The entire background of the Act and whether it is constitutionally valid has been discussed in detail in this article.

### **Constitutional provisions empowering entry tax**

Entry tax, as the name suggests, is an indirect tax imposed by a State on the entry of certain goods into a local area of the State for consumption, use or sale therein. Entry tax has been imposed by a State in pursuance of powers conferred under Entry 52, List II of the Seventh Schedule of the Constitution of India which provides as follows:

*“Taxes on entry of goods into a local area for consumption, use or sale therein.”*

### **Constitutional validity of entry tax**

Entry tax was claimed to be constitutionally valid by the state government on the ground that a taxing law may not be hit by Article 301 read with Article 304 as the tax sought to be imposed is compensatory in nature. Even the Supreme Court held that a taxing statute can be protected from the vice of unconstitutionality, if the tax is compensatory in nature. Further it was argued that the regulatory measures or measures imposing compensatory taxes for the use of trading facilities do not come within the purview of the restrictions contemplated by Article 301 and such measures need not comply with the requirements of the proviso to Article 304(b) of the Constitution.



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On the other hand the constitutional validity of entry tax has been questioned before various Courts on the ground that the tax is not compensatory in nature hence the levy violates Article 301 of the Constitution and is not protected by Article 304. This issue can be argued on the basis of the constitutional provisions and the related judicial pronouncements given below.

### **The Constitutional provisions given in Part XIII of the Constitution**

Supreme Court in the case of *Atiabari Tea Company, Limited vs. State of Assam and Others [1961-(048)-AIR -0232 –SC<sup>1</sup>]* has held that power to tax vested by the legislative list in the Parliament or State legislatures, is circumscribed by Part XIII (Trade, Commerce and intercourse within the territory of India) of the Constitution and if the exercise of that power does not conform to the requirements of Part XIII, it will be regarded as invalid. Hence vide this judgment, Hon'ble Supreme Court has confirmed that even tax legislation would have to bear the scrutiny of Part – XIII and in case the tax legislation infringes with the Part XIII of the Constitution, then the same will be held invalid and unconstitutional.

Part XIII of the Constitution deals with Trade, Commerce and Intercourse within the territory of India

#### ***Article 301***

Article 301 requires freedom of trade, commerce and intercourse throughout the territory of India, however this is subject to other provisions of the Part XIII.

#### ***Article 302***

According to Article 302, the Parliament may impose restrictions on the freedom of trade, commerce or intercourse between one State and another or within any part of the territory of India as may be required in the public interest.

#### ***Article 304***

Article 304 is a non-obstante provision, which restricts trade, commerce and intercourse throughout the territory of India. This article overrides Article 301 and 303, and states:

“Notwithstanding anything in article 301 or article 303, the Legislature of a State may by law—

- (a) impose on goods imported from other States or the Union territories any tax to which similar goods manufactured or produced in that State

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<sup>1</sup> <http://www.indiankanoon.org/doc/514162/>



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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:

Provided that no Bill or amendment for the purposes of clause (b) shall be introduced or moved in the Legislature of a State *without the previous sanction of the President.*”

### ***Power of State Legislature to impose entry tax***

Hence from the above provision it is clear that the state legislature can impose entry tax except when the tax directly and immediately impedes free flow of trade and commerce, as in such case it would violate Article 301. However, the Parliament can get rid of the limitation imposed by Article 301 by enacting a law under Article 302. Similarly, State Legislature by making law in compliance with the conditions imposed by Article 304, holds the act legal. The following three conditions are to be fulfilled under Article 304(b):

- i. The restriction shall be in public interest
- ii. It shall be reasonable
- iii. It shall be subject to procurement of prior sanction of the president

The tax can still be constitutionally valid even if the conditions under Article 304(b) of the constitution are not followed, if such tax is compensatory in nature. Hence it is very important to discuss whether entry tax is compensatory or not and to determine whether there has been a violation of the constitution or not.

### **Concept of Compensatory Taxes: Judicial Pronouncements**

The most important concept involved in the whole issue is “compensatory taxes”. The concept was first propounded in *Automobile Transport (Rajasthan) Ltd. v. State of Rajasthan*<sup>2</sup> wherein the constitutional validity of Rajasthan Motor Vehicles Taxation Act, 1951 was challenged. It was observed that *regulatory measures or measures imposing compensatory taxes* for the use of trading facilities did not hamper trade, commerce and intercourse rather it facilitated them and, therefore, *were not hit by the freedom declared by Article 301*; such measures need not comply with the requirements of the provisions of Article 304(b) of the Constitution.

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<sup>2</sup> <http://www.indiankanoon.org/doc/304499/>



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### **Working test for compensatory tax**

The working test to determine, whether a tax is compensatory or not is to enquire whether the trade people are using certain facilities for the better conduct of their business and are paying not patently much more than what is required for providing the facilities. Hence this judgment emphasized that the imposition of compensatory tax must be with definite purpose of meeting the expenses, on account of providing or adding to the trading facilities either immediately or in future, provided that the quantum of tax is based on a reasonable nexus to the actual or projected expenditure on the cost of the service or facility.

This working test was applied by all the Courts in India from 1962 to 1995 in relation to motor vehicles taxes to decide whether the levy was compensatory or not. However it would be impossible to judge the compensatory nature of a tax by a meticulous test, and in the nature of things that cannot be done.

### ***Supreme Court widened the ambit of compensatory tax***

It was then decided in the case of, *Bhagatram Rajeevkumar v. Commissioner of Sales Tax, M.P*<sup>3</sup> that the Hon'ble Supreme Court held:

“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 decision in *Bhagatram case* was relied on in case of *State of Bihar v. Bihar Chamber of Commerce*<sup>4</sup>. The Court held that that the State provides several facilities to the trade, such as, laying and maintenance of roads, waterways, markets etc. and on this premise, and hence the entry tax was compensatory in nature. Post these decisions the test applied was 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 brought within the concept of compensatory tax, the relationship between the compensatory tax and the trading facilities not being necessarily either direct or specific. These judgments stretched the concept of “compensatory taxes” as compared to the originally evolved idea of the same and were in contrast with the doctrine of direct and immediate benefit as propounded in

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<sup>3</sup> <http://www.indiankanoon.org/doc/1695248/>

<sup>4</sup> <http://www.indiankanoon.org/doc/1420108/>



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the *Automobile Transport (Rajasthan) Ltd. vs. State of Rajasthan* [AIR 1962-(049)-AIR - 1406 –SC]..

### ***Compensatory tax based on the doctrine of “direct and immediate effect”***

However, again in *Jindal Stainless Ltd. & Anr vs State of Haryana & Ors*<sup>5</sup> Hon’ble Supreme Court made a landmark judgment which held that:

“.....the doctrine of "direct and immediate effect" of the impugned law on trade and commerce under Article 301 as propounded in *Atiabari Tea Co. Ltd. v. State of Assam* and the working test enunciated in *Automobile Transport (Rajasthan) Ltd. v. State of Rajasthan* for deciding whether a tax is compensatory or not, will continue to apply and the test of "some connection" indicated in the judgment of *Bhagatram Rajeevkumar v. Commissioner of Sales Tax, M.P* and followed in the case of *State of Bihar v. Bihar Chamber of Commerce* is, in our opinion, not good law.”

### **Guidelines laid down by the apex court for introducing compensatory entry tax**

The Supreme Court had laid down the guidelines for introducing such a compensatory entry tax on the basis of the judgment in case of *Jindal Stainless Ltd Vs the State of Haryana*, to make the government accountable for beefing up infrastructure. The guidelines provide that entry tax should be a compensatory tax till such time as it is required to improve infrastructure such as roads, markets and power, and the proceeds of the tax have to be utilized exclusively for the development of trade, commerce and industry and the activities specified. The fund cannot be utilized for other purposes. The guidelines highlighted the following:

- i. The concept of compensatory tax is not there in the constitution but has judicially evolved in *Automobile Transport* case as a part of regulatory charge.
- ii. Compensatory tax is a compulsory contribution levied broadly in proportion to the special benefits derived to defray the cost of regulation or to meet the outlay incurred for some special advantage to trade, commerce and intercourse. It might incidentally bring in net revenue to the government but that cannot be an essential ingredient of the compensatory tax.
- iii. Whenever any law is impugned as in violation of Article 301 of the Constitution, the courts have to verify whether the impugned enactment facially or patently

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<sup>5</sup> <http://indiankanoon.org/doc/1962644/>

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- indicates quantifiable data on which compensatory tax is sought to be levied. The Act must facially indicate quantifiable or measurable benefit.
- iv. If the provisions are ambiguous/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/to be provided to its payers.
  - v. Once it is shown that the enactment invades freedom of trade, it is necessary to enquire whether the State has proved that the restrictions imposed by it by way of taxation satisfy the conditions laid down in Article 304(b) as already discussed above.

### **Entry tax based on the “principle of equivalence”**

We have to make it clear that the basic difference between a tax and a fee or a compensatory tax is, a tax is based on the concept of burden, whereas a fee or a compensatory tax is based on the concept of recompense and/or reimbursement. A fee or compensatory tax is based on the "principle of equivalence". This principle is the converse of the "principle of ability" to pay. The basis of a fee or a compensatory tax is the same. The main basis of a fee or a compensatory tax is the quantifiable and measurable benefit. Thus entry tax to be compensatory in nature has to be based on the 'principle of equivalence' and/or 'quid pro quo' and/or 'pay for value'. Thus it should be based on the principle of direct and immediate effect.

### **Background for introduction of the 'West Bengal Tax on Entry of Goods into Local Areas Act, 2012'**

The entry tax proposal was laid down during the era of the preceding Left Front government. It had then sent the entry tax proposal for the President's assent in 2003 but didn't pursue it after 2010. Later with Bengal's treasury in a desperate condition, Finance Minister, Mr. Amit Mitra introduced entry tax in 2012.

The object of the Entry Tax Act, as stated in its preamble is to provide for levy and collection of taxes on the entry of certain goods into a local area of the State of West Bengal, for consumption use or sale therein and to provide for matters connected therewith, or incidental thereto, for the purpose of creating a Compensatory Entry Tax Fund.

On the Act being enforced in West Bengal Mr. Amit Mitra hailed its contribution to the state's revenue and had assured the assembly that there was no need to obtain presidential



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assent for compensatory entry tax. A large group of business houses and traders moved to the high court, challenging the very validity of the Act.

### **Constitutional Validity of Entry Taxes: In the present case**

The impugned Entry Tax Act facially provides for a levy for the purpose of creating a compensatory Entry Tax Fund. It also facially indicates some of the purposes for which the proceeds of the Entry Tax collected may be utilized, that is, the purposes enumerated under Section 18 most of which, if read and understood as per their plain meaning pertain to general development of the State, and are within the ambit of the general duties of the State to all its tax payer.

Further under Entry 52 of List II of the Seventh Schedule, it would be evident that Entry Tax levied and collected from one local area had to be spent for the benefit of the trading people of the said local area itself in order to make the levy compensatory.

### ***Grounds of challenge***

The Calcutta High court held the State's Entry Tax Act as unconstitutional in view of the above judgment in Jindal Stainless (supra) on the two foremost grounds:

- i. The state did not take the President's assent before imposing it.
- ii. The tax was not compensatory in nature.

“The question is whether the impugned Act meets the facial test laid down by the honourable Supreme Court in Jindal and whether the data placed on record by the State shows that the impugned levy functionally is compensatory and provides quantifiable or measurable benefit to the payers of the tax?”

The Court held that the levy of entry tax was not compensatory in nature, it was meant to be for assistance to local areas for their development generally. Although Mr. Amit Mitra had said the levy was designed to be "compensatory in nature", and that the entire tax shall go to a "dedicated fund" which he had set up in the name of "Compensatory Entry Tax Fund" for upgrading and to boost infrastructure by way of - building of roads, bridges, linking of markets, setting up storage facilities and supply of electricity and water to industries and commercial complex. But during its submission in court, the State Government couldn't quantify the benefits to local area trade and commerce as mentioned in the purpose of the Bill.





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### ***Decision made by the Calcutta High Court***

Justice Banerji in light of the above discussion held that Entry Tax Act is not compensatory in nature. This is because, the amount of Entry Tax collected is credited to the Consolidated Fund of West Bengal under Section 16 of the Act and the same is to be appropriated by the State Legislature. The provision of Article 266 of the Constitution of India, read with Section 16 of the Entry Tax Act makes it amply clear that the proceeds under the Entry Tax Act are to be treated by the State Government as revenue received by it. This fact is sufficient to declare the levy as not compensatory in nature, as it loses the character of 'fee' and assumes the character of 'tax'. Thus the Act is for augmenting the general revenue and cannot be treated to be compensatory. Further for a tax to be compensatory in nature, there has to be some link between the quantum of tax and the facilities or services for which the tax was being imposed.

Referring the matter back to the Jindal case the reason for not referring the tax as compensatory in nature can be:

“... the levy is not to meet the cost of any specific facility already provided or planned to be provided. The parameters clearly laid down in Jindal are that compensatory tax represents the costs incurred in procuring facilities/services on the principle of "pay for value". It is a charge for offering trade facilities. It adds to value of trade and commerce. It is based on the principle of equivalence. It must have a broad proportion to the benefit derived to defray the cost of regulation or to meet the outlay incurred for some special advantage to trade and commerce and intercourse. The impugned levy initially was meant to be for assistance to local areas for their development generally. Entry tax is therefore, held to be a restriction on free flow of trade and commerce and is hit by Article 301 of the Constitution of India. Hence to get rid of the limitation imposed by Article 301 and to hold the act legal, the State Legislature while making law had to comply with the conditions imposed by Article 304(b). One of such condition was to obtain prior permission of the President of India before enactment of the Act, which the State Government has not obtained.

## **Constitutional provisions other than part XIII**

### ***Article 286***

Article 286 of the Constitution of India, prevents the State Legislature from imposing tax on sale or purchase of goods, when such sale or purchase takes place in course of import of goods into or export of goods out of the territory of India, has also been violated. The reason being that under Section 2 (h) of the Entry Tax Act, the term entry of goods has been defined. The Entry Tax Act provides for levy of tax on entry of goods from outside



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the country into any local area within the State of West Bengal. By providing for levy of Entry Tax on entry of goods from outside the country, the State Legislature has acted beyond its legislative competence and has transgressed the power of the Parliament.

### **Article 199(1)(d)**

Under Article 199(1)(d) of the Constitution of India, any appropriation of money out of the Consolidated Fund of the State had to be done by way of Money Bill. Thus, the Entry Tax collected by the State is to be treated as general revenue at the hand of the State, at the first instance, and is to be credited into the State Consolidated Fund. Its utilization would directly be dependent upon budgetary allocation to be made by the State Legislature by way of ‘Money Bill’. The same procedure has not been followed by the state government with respect to the Act.

It is further reiterated that a compensatory tax would not cease to be a compensatory tax, only because of some excess collection, which may have to be diverted towards the revenue of the State. However, imposition of the tax would necessarily have to be preceded by the exercise of ascertaining the approximate financial requirements for specific and/or earmarked projects and balancing the same with the targeted tax receipts. The State should be able to justify the basis on which the rate of tax has been determined.

## **Conclusion**

The West Bengal government had not obtained any such approval before introduction of the “West Bengal Tax on Entry of Goods into Local Areas Act, 2012” which has come into effect from 1st April, 2012. This Act has been challenged in the case of Bharti Airtel vs. State of West Bengal and Others<sup>6</sup> and as a result came the judgment of Justice Indira Banerji, striking down the tax and declaring the Act “unconstitutional”. However, the operation of the judgment has been stayed for six weeks to give time to the state to appeal, which is very much obvious to happen as the State will not let go the huge chunk of money so easily.

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<sup>6</sup> <http://indiankanoon.org/doc/1962644/>