

Subject: LAW

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Paper : ADVANCED CONSTITUTIONAL LAW

Module : INTER-STATE TRADE AND COMMERCE


A Gateway to All



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Item	Description of Module
Subject Name	Advanced Constitutional Law
Module Name	Inter-State Trade and Commerce
Module Id	28
Pre-requisite	Basic Knowledge of fundamental Rights relating to Trade And Commerce
Objectives of Module	To understand the concept of freedom of inter-state and intra state trade
Key words	Inter-state trade, intra state trade, Article 301, compensatory tax

Module : 28 : Inter-State Trade and Commerce

Structure :

- 1. Introduction**
- 2. Learning Outcome**
- 3. Pre- Constitutional Position**
- 4. Freedom of Trade and Commerce: Constitutional History**
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1. Introduction

The free flow of trade, devoid of geographical obstruction, is a *sine qua non* for economic affluence, on a national scale as well as globally. To give effect to the same, the European Union has consequently detached blockade between the countries. Though, India is following a federal structure but still, as far as trade among the states is concerned there was a need for synchronization of the same which can provide better viable condition for economic growth. Consequently, Inter-State Trade and Commerce fall within the purview of Central accountability. For example, Part XIII (Articles 301 to 307) is devoted exclusively to trade and commerce and there is a general declaration in the Indian Constitution that trade and commerce should be free, and the states and especially the Centre have the power to regulate.¹

2. Learning Outcome

- Freedom of Trade and Commerce has been an important vital in the economic prosperity of the State.
- To ensure same and taking into consideration the Federal Form of Government Section 297 of the Government of India Act, 1935 was enacted
- Section 92 of Australian Constitution played an important role while enacting Section 301 to 307 under the Independent Constitution by the constituent assembly
- From the principle of free movement laid down in Atibari's case the apex court laid down the theory of Compensatory and regulatory measures in Automobile's Case
- In *Jindal Stainless Ltd's case* the supreme work reiterated the working test laid down in *Automobile's case*
- In *Jaiprakash Associates Ltd's case* the matter of entry tax is referred to larger constitutional bench

¹Bibek Debroy and P.D. Kaushik, *Barriers to Inter-State Trade and Commerce-the case of Road Transport*, RGICS Paper No.35 (New Delhi: Rajiv Gandhi Institute for Contemporary Studies, 2002) [PDF Version: 2010] available at <<http://www.rgics.org/pdf1/wpn-35.pdf>> accessed on 19 May, 2014.



3. Pre- Constitutional Position

In order to appreciate all aspects of Article 301 to 307 in the right perspective it is necessary to have a look into the historical perspective of the provisions laid down in Part XIII. It is a familiar fact that before Independence, in 1947, nearly one-third of the territory of India consisted of mainly native states governed by Indian Princes. Many of these States claimed anecdotal degrees of sovereign rights subject to limitations imposed by the paramount power. In this backdrop the States were exercising their power of imposing taxes and levying duties and creating tariff obstruction hindering the flow of trade, commerce and intercourse among themselves. At that point of time, British India was governed by the provisions of Section 297 of the Government of India Act, 1935.²

The Government of India Act, 1919 introduced the system of diarchy by which an initial step towards the federal system was taken in the form of division of powers between states and the Centre following the federal pattern of Government. In the light of this Provincial Governments were given the subjects which were less significant and was parochial in nature. In 1927, Simon Commission suggested federal form of government but was never in favour of giving tax levying power to the State Governments. Finally in 1933 a joint committee was appointed to examine the workable pattern for the new Constitution i.e. 1935 Act. On the basis of which the Government of India Act, 1935 which formally introduced the federal system providing a separate list for federal, Provincial and concurrent. Entry 27 of Provincial list acknowledged the freedom of trade and Commerce which was regulated by the Governor General under his residuary powers. Section 297 of 1935 Act specifically imposed limitation on the powers of provinces prohibiting them from imposing trade barriers on the entry and export of goods and it further prohibited the levying of taxes on the goods manufactured and produced in the State and outside the State. In *Bhola Prasad vs. R*³ the validity of parochial law prohibiting the possession, sale, import, export of intoxicating liquor was questioned in the court of law. The federal Court held that it is not violative of Article 297 of 1935 Act as the power is exercised by the Provincial Government under Entry 31 of the Provincial list. Though section 297 acknowledges the economic unity of provinces but the matter again turned for further deliberation to the framers of the Constitution of independent India.

4. Freedom of Trade and Commerce: Constitutional History

While enacting Article 301, the Constituent Assembly deliberately tried to adopt section 92 of the Australian Constitution. Movement is an essential ingredient of trade and commerce and there must be no fetter on it; any taxation would be a fetter. Section 92 of the Constitution of Australia ensures that the trade, commerce and interstate intercourse *via* internal carriage or ocean navigation shall be absolutely

²For details see, chapter XVIII-Trade, Commerce and Intercourse within the territory of India, available at <<http://interstatecouncil.nic.in/Sarkaria/CHAPTERXVIII.pdf>> accessed on 19 May, 2014.

³ [1942] F.C.R, 17



free except for imposition of uniform duties of customs. However newly created states have an additional liability regarding the above for a period of two years.⁴

Its basic principles were formulated in the notes submitted to the sub-committee on Fundamental Rights by K. M. Munshi, AlladiKrishnawamiAyyar and B. N. Rau. The sub-committee discussed B. N Rau's draft provision. The provision is reproduced as under:

'Subject to regulations by the law of the Union, trade, commerce and intercourse among the units, whether by means of internal carriage or ocean navigation shall be free:

Provided that any units may by law impose reasonable restrictions thereon in the interest of public order, morality or health.'⁵

B. N. Rau pointed out that the first paragraph of the clause was an adaptation from Section 92 of the Australian Constitution while the proviso was new.⁶ Commenting on the clause when the draft of the sub-committee's report was under consideration, Alladi Krishnaswami Ayyar suggested that (i) goods entering a particular units of the Union should not escape duties and taxes to which goods produced in the concerned unit itself were subject; (ii) it must be open to a unit in an emergency to place restrictions on inter-state trade and commerce; (iii) the freedom of trade guaranteed in the clause should specifically cover coastal trade; and (iv) it should be clearly laid down that this right would not extend to non-citizens carrying on trade.⁷ These suggestions were accepted by the sub-committee and the advisory committee further that 'social reform" should be added expressly as a valid ground for restricting freedom of trade and commerce.⁸

Rajagopalchari expressed the view that units should be given power to impose custom duties and other taxes for genuine revenue purposes. The second amendment provided that the right of a unit to tax the goods coming from other units would only be exercised under regulation and conditions which were non-discriminatory. Both these amendments and the clause as amended thereby were adopted by the Assembly without much discussion.⁹

⁴Section 92 of Australian Constitution:

On the imposition of uniform duties of customs, trade, commerce, and intercourse among the States, whether by means of internal carriage or ocean navigation, shall be absolutely free. But notwithstanding anything in this Constitution, goods imported before the imposition of uniform duties of customs into any State, or into any Colony which, whilst the goods remain therein, becomes a State, shall, on thence passing into another State within two years after the imposition of such duties, be liable to any duty chargeable on the importation of such goods into the Commonwealth, less any duty paid in respect of the goods on their importation.

Saurabh Kumar, 'Freedom of Trade, Commerce and Intercourse- Federal Prologue' available at<<http://www.desikanoon.co.in/2014/04/freedom-of-trade-commerce-and.html>> accessed on 20 May, 2014.

⁵ B. Shiva Rao (ed.), *The Framing of Indian Constitution*, (Government of India, 1966 Vol. 3), 9.

⁶Subhash C. Kashyap, *The Framing of Indian Constitution: A study* (Universal Law Publishing Co. Pvt. Ltd.) 699.

⁷*Ibid.* pp. 699-700.

⁸Report, para 6, Annexure, Clause 14 and K.T. Shah's note of dissent, para 9. Select Documents II, 4(viii), pp. 170, 173. 193.

⁹*Kashyap*(n 6),700-701.



The Draft Constitution after much deliberations included the provision as follows:

Subject to the provision of any Federal Law, trade, commerce and intercourse among the units shall, if between the citizens of the federation, be free...¹⁰

In a subsequent note, B. N. Rau added the words “if between the citizens of the federation” might create needless complications in practice. It would be inconvenient if there were internal trade barriers across which free trade was allowed if and only if it was between the citizens of the Federation; for in that case some means would have to be devised for ascertaining the nationality of the consignor and the consignee. Accepting the soundness of B. N. Rau’s argument, the drafting Committee decided to omit these words.¹¹ With some further modifications the clause was retained in Fundamental Rights Chapter in the Draft Constitution of February, 1948. The provisos were redrafted and included as independent articles under a separate heading, namely, “Inter-State Trade and Commerce” in Part IX of the Draft Constitution dealing with the relation between union and the States.¹²

The first perusal of the provision without an iota of doubt seems to be inspired from Section 92 of the Australian Constitution except the one basic distinction that under Indian constitution the power has been given to centre to regulate the trade. Later on, on the recommendations of the Committee headed by AlladiKrishnaswamiAyyar, several changes were made and after a long discussion, in a final report, the freedom of trade and commerce appeared under Part XIII of the Constitution, covering Article 301 to 307.

5. Post- Constitutional Scenario

Article 301 and 307 lays down the provision relating of trade commerce within territory of India. Article 302 enables Parliament to impose restrictions on the freedom, commerce and intercourse on the ground of public interest. Article 303 prohibits the Parliament and the State legislatures to make preferential and discriminatory law.

In the land mark case of *Atiabari Tea Co. v. State of Assam*¹³ the Assam State enacted a law called Assam Taxation (on Goods Carried by Roads or Inland Waterways) Act, 1954 imposing taxes on goods carried by road or inland waterways in the state of Assam. The appellants moved to the High Court praying for a writ of mandamus or any other writ restraining the respondents from taking any steps under the provisions of this Act. The Supreme Court took the view that if the movement, transport or the carrying of goods is allowed to be impeded, obstructed or hampered by taxation without satisfying the requirements of Part XIII the freedom of trade on which so much emphasis is laid by Article 301 would turn to be illusory. When Article 301 provides that trade shall be free throughout the territory of India primarily

¹⁰*Constitutional Assembly Debates*, Vol. III, pp. 465-468.

¹¹*Kashyap*(n 6), 701.

¹² *Ibid.*

¹³AIR 1961 SC 232



it is the movement part of the trade that it has in mind and the movement or the transport part of trade must be free subject of course to the limitations and exceptions provided by the other Articles of Part XIII.¹⁴ The Court failed to take into consideration the quantum of tax burden, which by no means was excessive but the tax was levied on 'movement' of goods, from one place to another, it was held to offend Article 301. The view propounded in *Atiabari* was bound to have great adverse effect upon the financial autonomy of the states. Thus, 'freedom of trade, commerce and intercourse from laws' became 'freedom of movement of trade from direct and immediate restrictions imposed by laws'.¹⁵

In *Automobile Transport v. Rajasthan*¹⁶ the State of Rajasthan levied a tax Rs. 60 on private motor cars i.e. Rs. 12 per seat and Rs. 2000 on a goods vehicle per year with a load capacity of more than five tonnes through Rajasthan 'Motor Vehicles Taxation Act, 1951. Section 4(1) of the same Act provides that unless the owner paid the respective tax with the appropriate time mentioned in schedule 5 no motor vehicle shall be used in any public place or kept for use in Rajasthan. The validity of the above referred tax was challenged in this case and keeping in view that whether the tax burdens trade or impairs the freedom of trade and commerce as envisaged under Article 301. The Supreme Court observed that the tax imposed is not violating the right guaranteed under article 301 as the tax is compensatory in nature. The Apex court further turned up with a liberalized theory where of regulatory and compensatory tax. The Court further observed that the toll tax for usage of bridges, traffic regulations, maintenance of roads from wear or tear etc., are the regulatory measures which facilitate trade rather than hampering the same. Therefore, if any tax facilitates trade and commerce within the state will not be amounting to restriction but if the same impedes or encumbers the trade and commerce within the state it will be amounting to restriction.

The theory of compensatory and regulatory measures was taken into consideration by the Court in *Automobile*. Das, J., accepted the *Atiabari* formulation noted above, with the one 'clarification' that:¹⁷

“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.”

The justification of a compensatory tax is the same. A tax imposed on traders is compensatory in nature when it *really facilitates* trade, by providing better trade facilities. In the words of Das, J.,¹⁸

¹⁴ *Ibid.* For details see para 59

¹⁵ V. Niranjan, 'Interstate Trade and Commerce: The Doctrine of Proportionality Reaffirmed', 2 Ind. J. Const. L. (2008).

¹⁶ AIR 1962 SC 1406

¹⁷ Niranjan (n 18).

¹⁸ *Ibid.*



“...[a compensatory tax is] making a charge for the use of trading facilities, such as, roads, bridges, aerodromes etc. The collection of a toll or a tax for the use of a road or for the use of a bridge or for the use of an aerodrome is no barrier or burden or deterrent to traders who, in their absence, may have to take a *longer or less convenient or more expensive route*. Such compensatory taxes are no hindrance to anybody’s freedom...”

The Automobile’s case turn aside the emerging prospect of extensive observation gaining recognition that ‘trade and commerce’ concerned barely with the ‘movement of goods’, and determined the tax law dispute by laying down a middle path - taxes which proportionately benefit trade (compensatory tax) do not require Presidential consent, thereby not touching an area of State independence unscathed.

In *Bolani Iron Ores v. State of Orissa*¹⁹ in this pertinent case the question before the Court was to determine that whether Dumpers, Rockers and Tractors are motor vehicles under the concerned State Motor Vehicles Taxation Acts, and are accordingly taxable there as these vehicles are not anticipated nor adapted for use on public roads and the same had not been used by the aggrieved on public roads or public place. The apex court observed that as far as dumpers and rockers are concerned they are not taxable till they are used in the premises of the owners. The Apex Court further observed that the taxation power granted under entry 57 List II is compensatory in nature and it cannot be used when there is no nexus with the vehicles which are not to be used on the roads.

In *G.K. Krishnan v. State of Tamil Nadu*²⁰ the validity of motor vehicle tax which increased the rate from Rs. 30 to 100 per seat per quarter was questioned in the Supreme Court. The question for determination was that a non discriminatory tax imposed by the state can be challenged under Article 301 as a restriction on trade and commerce. The apex Court liberalized the taxing power of State and held it fall within the purview of compensatory tax and hence valid. They took into purview the tax collection i.e. over 16 crores vis-à-vis the expenditure i.e. 19.51 crores. In another case *International Tourist Corporation v. State of Haryana*²¹, the transporters challenged the validity of the tax imposed by the Haryana Government on the transporters who were plying vehicles from Jammu and Kashmir to Delhi on the ground that the responsibility for constructing and maintaining of national highways is upon the Central Government not the State Government. The transporters further argued that the tax is not compensatory in nature. The Supreme Court rejected this contention and held that to determine the validity of tax imposition it is essential to take into consideration the existence of a specific, 'identifiable' object behind the levy and a 'sufficient nexus' between the 'subject and the object of the levy.' In the present case, the State incurs substantial expenses for maintenance of roads and providing facilities for transport of goods and passengers, hence the tax imposed is valid.

¹⁹ 1975 SCR (2) 138

²⁰ 1975 SCR (2) 715

²¹ AIR 1981 SC 774.



In *Jindal Stainless Ltd. & another v. State of Haryana and others*²² in the pertinent case a group of appeals, challenged the constitutional validity of the Haryana Local Area Development Tax Act, 2000 was on two issues:

1. that the above mentioned Act is violative of Article 301 and is protected within the purview of Article 304;
2. that the above mentioned Act seeks to levy sales tax on inter-State sales, which doesnot fall within the ambit of the State Legislature.

The Hon'ble Supreme Court in a five Member bench in this case observed and laid down the parameters to determine the validity of tax statutes on the scale of compensatory tax:

- Compensatory tax is judicially evolved concept as a consequence of Automobile case.
- Compensatory tax is a mandatory contribution in proportionate to special advantage to trade and commerce
- Impugned law will be verified on the quantifiable or measurable benefit to test the infringement under Article 301
- If the impugned law is not clear on the quantifiable or measurable benefit the onus is on the State to prove that the compensatory tax is a reimbursement/ recompense for the above referred benefit
- Whenever a State enactment invades freedom of trade, it is essential satisfy the conditions laid down in article 304(b) i.e. public interest; reasonability and procurement of prior sanction of the president.

Further the Hon'ble Supreme Court also decided that constitutional validity of various entry tax enactments, which are subject matter of pending appeals; SLP's and writ petitions will be disposed of in the light of above principles. It was concluded 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*²³ and the working test enunciated in *Automobile Transport (Rajasthan) Ltd. v. State of Rajasthan*,²⁴ for deciding whether a tax is compensatory or not will continue to apply and the test of 'some connection' indicated in the judgement of *Bhagatram Rejeev Kumar v. Commissioner of Sales Tax*²⁵, and followed in the case of *State of Bihar v. Bihar Chamber of Commerce*²⁶, was not good law. The preceding

²²AIR 2006 SC 2550.

²³*Atiabari* (n 16).

²⁴*Automobile* (n 19).

²⁵ (1995) Supp 1 SCC 673; (1995) 96 STC 654 (SC) In Bhagatram's case (which was decided by a Bench of three Judges, the challenge was to the M.P. Sthaniya Kshetra me Mal ke Pravesh par Kar Adhinyam, 1976. In that case, although it was demonstrated by the State and not disputed by the assessee that the levy was compensatory, nevertheless, the Court went on to say that 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 dealers directly or indirectly, the levy cannot be impugned as invalid.

²⁶ (1996) 9 SC 136; (1996) 103 STC 1 (SC), The dictum in Bhagatram's case was relied on by a Bench of two Judges in the case of Bihar Chamber of Commerce's case, which reiterated the position that 'some connection' between the tax and the trading facilities extended to dealers directly or indirectly is sufficient to characterise it as compensatory tax. The Court went further to hold that the State provides several facilities to the trade, such as laying and maintenance of roads, waterways, markets, etc. and on



deformation, commenced when in *Hansa Corporation*²⁷ and *Geo Miller*²⁸, symptomatic of that a tax imposed is compensatory in nature when it compensates the 'State' for loss of revenue. Thus, the test laid down and initiated in the *Automobile's case* as the uncomplicated suggestion that a tax will be compensatory if it benefits the trade proportionately was changed to a tax which does not benefit trade proportionately is still compensatory and supplementary the same to a tax is compensatory if it benefits the State. However, *Jindal Steel case* appropriately took precedence over *Bhagatram and Bihar Chamber of Commerce*. While analyzing the distinction between a compensatory tax and a fee it emphasized on the doctrine of proportionality overruling the other proposals.

6. Conclusion

In the case of *Jaiprakash Associates Ltd. v State of M.P.*,²⁹ two member bench of the Supreme Court had referred the Entry Tax case to Chief justice for constituting a suitable larger constitutional bench to consider the matter relating to entry tax and whether the matter is violative of Article 301.

Article 301 to 307 guarantees that the trade, commerce and intercourse shall be free throughout the territory of India with common restraint on the exercise of legislative power, whether of the Union or of the States, to secure unhindered flow of trade, commerce and intercourse from one part of the territory of India to another. The Judiciary has played a crucial role in developing the principles from direct and immediate restrictions to regulatory or compensatory taxes. But this freedom has gone along way through judicial interpretation.

7. Summary:

Freedom of Trade and Commerce has been the important vital in the economic prosperity of the State. To ensure same and taking into consideration the Federal Form of Government Section 297 of the Government of India Act, 1935 was enacted. In enacting article 301 to 307 i.e. provisions relating to trade and commerce Section 92 of Australian Constitution played an important role. The module further highlights the principle of free movement laid down in *Atibari's case* the apex court laid down the theory of Compensatory and regulatory measures in *Automobile's Case*. The scheme of the Articles in Part XIII, considered as a whole, is well-balanced. It reconciles the imperative of economic unity of the Nation with interests of State autonomy by carving out in clauses (a) and (b) of Article 304, two exceptions in favour of State legislatures to the freedom guaranteed under Article 301.

this premises, it was held that the entry tax was compensatory in nature. The learned Judges did not consider it necessary to put the burden on the State to furnish the details of facilities provided to the traders and the expenditure incurred or incurable thereafter.

²⁷ *State Of Karnataka v. M/S. Hansa Corporation* AIR 1981 SC 463

²⁸ *Geo Miller v. Madhya Pradesh* AIR 2004 SC 3552

²⁹ 2008 (16 SCALE 90).



8. Interesting Facts:

- Compensatory tax is judicially evolved concept as a consequence of Automobile case.
- In Jaiprakash Associates Ltd. v State of M.P., two member bench of the Supreme Court had referred the Entry Tax case to Chief justice for constituting a suitable larger constitutional bench to consider the matter relating to entry tax and whether the matter is violative of Article 301.

9. Points to Ponder:

- Judicial decisions regarding freedom of trade commerce and intercourse still there has been no evolution of any straight jacket formulae to decide the nature of tax and judicial decision.
- Trade, commerce and intercourse have the widest connotation and cover almost all the commercial activities.
- The freedom guaranteed is not only from the laws enacted in the exercise of the powers conferred by the related legislative entries but also the tax laws.
- Taxes that directly hamper the trade or business will be void otherwise not.
- Laws, which are purely regulatory and compensatory in nature, are not violative of the Freedom so guaranteed.
- The Indian polity has a federal structure but still an arrangement is necessary to ensure harmonisation and facilitate Inter-State Trade and Commerce without hindrances.

10. Glossary

Starting words	Term	Definition
C	Compensatory Tax	Compulsory charge levied by a government for the purpose of redressing or countervailing economic disparity
I	Intra-state Commerce	The commerce which is confined within the territory of state
I	Inter-state Commerce	Trade and commerce which Overflows the boundary of one state and which extends to two or more states
T	Trade	Action of buying and selling things
T	Tax	a compulsory contribution to state revenue



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