

Centre State Relations in India

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Week 06: Financial Relations: Allocation of Taxing Power; Distribution of Revenue, Goods and Services Tax, GST Council

Lecture 28: Inter State Commerce and Inter-Commerce Commission under Art 307

Greetings to all of you. We are discussing financial relations and in that we have discussed the transformational change which has been brought through GST in India, where an attempt has been done to create a common market on indirect tax regime. We have also discussed the distribution of revenue between the Centre and the States and what role the constitutional body Finance Commission plays in dividing the revenue between the Centre and the States. Now, on financial relation there is another important set of provisions which plays a very significant role in creating common market in this country and that is Part XIII of the Constitution which deals with inter-State commerce and intercourse. When you look at Part XIII of the Constitution you would find that this is something which connects with free trade and apparently not related to federal relation, but a deeper analysis of the provisions in Part XIII establishes that how Part XIII strengthens the Centre State relation and how in the name of creating or establishing common market confers power to the Parliament to interfere. So, that is what we will discuss in today's session.

We will try to look at the historical background what has been debated in the Assembly debates while talking on inter-State trade and commerce. Literature indicates that this provision had got an influence from Australian provision under Section 92. So, we will also discuss that. We will also look at that how the court has been interpreting Part XIII and playing its role in giving effect to the scheme of creating a common market in India as it is envisaged under Part XIII of the Constitution.

We will also look at what Sarkaria Commission report has stated on this because there is a dedicated chapter on inter-State trade and commerce in the report and then we will also briefly discuss the relevance of Article 307 which talks about establishment of an authority by Parliament to give effect to the design let down under Part XIII of the Constitution. Trade plays an important role in improving life and livelihood. Trade also can be seen as an instrument for creating differences between the regions. The richer one would try to exploit more and not to agree with parting of resources with poorer regions or the State which is better on industrial growth may try to come up with legislative measures including on taxation to create disadvantage vis-à-vis others. So, trade has got a vital role to play in establishing economic unity because if trade is free throughout the territory then that would symbolize economic unity that would symbolize stability and that will also ensure prosperity across the regions in a federal setup.

Because in federal setup we need to understand that it is not only about establishment of two sets of two sets of government drawing legitimacy from the Constitution it is also about committing and fulfilling a standard living for people residing in every region that is also one of the task of both the set of governments. So, free flow of trade within an across inter-State border is important for improving, for strengthening, for anchoring federal spirit let down under the Constitution. If the movement of goods and services are happening without any barrier then one can very conveniently arrive at the conclusion that there is no bottlenecks created by federating units or no unnecessary measures are being taken by the federal government. So, free inter-State trade testifies collaborative and cooperative approach between constituent units between the States and federation demands that there shall be no barrier or minimal barrier between the States or within the States and what it leads to? It leads to creating a common market for entire country and in a way it fosters national unity among populace despite having a distinct culture different language different religion. Trade is a neutral phenomena and free trade will strengthen the bondages between the States and between individuals as well. Thus, in India you would find there is a categorical provision which refers to freedom of inter-State trade and commerce throughout the territory of India.

But one can really visualize that when you talk about free it is not absolute it can never be an absolute. Restrictions can be imposed in public interest that is what we will be looking at. Now

when you look at what is the provision under the Indian Constitution you would find that Articles 301 to 307 says that trade commerce and intercourse shall be free throughout the territory of India. So, exchange of goods, buying, selling of goods and services, communications, transport all these shall be free throughout the territory and throughout the territory here symbolizes not only inter-State trade but it also brings in intra-State trade because even in a State there is a developed region there is an underdeveloped region. So, the mandate of Part XIII and particularly Article 301 is to address both inter-State and intra-State domains.

So, when you look at the language of Article 301 it says that there shall be free trade throughout the territory. One can imply that the provision of Article 301 limits the legislative power of the Union and States on such matter. So, even though there is subject matter jurisdiction conferred on Parliament or the State Legislature such exercise of jurisdiction shall not be approved if it impinges upon the constitutional goal of free trade. Apart from Article 301 we have also got an Article 19(1)(g) which talks about movement of individual. Article 19 applies only to citizens. So, it is all about movement of citizen that every citizen of the country they have got a right to carry on trade or business and that trade or business can be carried out in any part of the country.

So, when you read different provisions of Article 19(1) there also you get a clear mandate of creating India into a common market and that is getting further supplemented by Article 301. The only difference is that Article 19 talks about rights to citizen whereas, Article 301 talks about not only individual which could be a non-citizen also, but also of corporations or for that matter even State. What were the relevant provisions in pre-constitutional era on free trade? Prior to 1950 Britishers were governing this country either through the direct control or through indirect control where they had allowed rulers of the native States to govern the geographical region with a kind of acceptance of sovereignty of British monarch. So, limited sovereignty was given to princely States and one third regions of the area governed by Britishers were under princely States. Therefore, in pre independence time it was seen that those princely States were imposing taxes for the purpose of augmenting revenue generation and that was in a way obstructing free trade.

And that is why Section 297 was brought in Government of India Act 1935 to eliminate such effect of imposition of taxes. Section 297 provided that provincial legislature or government

shall not pass any law or take executive action or the power to impose tax. So, this Section prohibited legislative or executive action on the matter of entry or export of any goods or impose of any tax, cess or toll on any goods manufactured in that province or any other provinces. And to that extent it says that provincial legislative would be invalid. Now when the framers they sat together to discuss the structure of a new Constitution for an independent India, they deliberated upon the significance of free trade because they were aware of the fact that free trade is very vital for not only bringing economic prosperity, but also for maintaining unity, unity of a different kind not a political unity but economic unity.

Therefore, the Sub-Committee on Fundamental Rights adopted the draft provision suggested by Mr. BN Rau on free trade on commerce, where it was suggested that that let the free trade on commerce among the unit be subjected to law made by the Union. So, the members in the Assembly they were of the view that the State shall be granted autonomy on the matter of trade and commerce, no need to empower the Union for intervention. They were of the opinion that if you allow Union to interfere then it would go against the idea of federal setup, where independency has been given to the State under the Constitution and that should not unnecessarily be again taken away through other route. It was suggested that that the such kind of freedom would be there, but at the end of the day it was seen that looking at the larger objective of creating national market, common market the proposition given by Mr. BN Rau was accepted that let the Union shall have some say when it comes to regulating free trade whether on the matter of inter-State or intra-State.

And it was suggested that while drafting this, reference was drawn from Section 92 of the Australian Constitution, where it was said that that let us look at Section 92 that how Section 92 deals with situation of free trade in the country. Then one distinction is there between Section 92 and Part XIII or particularly Article 301 that Article 301 deals with throughout the territory meaning thereby the scope of Article 301 goes beyond inter-State trade and also covers intra-State trade. It is also suggested that by Mr. BN Rau that let this provisions related to free trade be part of fundamental rights. But later on it was decided that instead of bringing it within fundamental rights let it be a separate part in the Constitution as Part XIII. So, this is the outcome of the deliberation in the Constituent Assembly, where you find that Article 301 talks about

general principle, where it says that there shall be free trade commerce and intercourse, buying selling of goods, exchange of goods, transportation, and transmission.

Article 302 allowed Parliament to impose restrictions in the name of public interest. Article 303 prohibited Parliament and the State Legislatures from making any law giving any preference to one State over another State. So, Parliament or the State Legislature was allowed to not to discriminate except in a situation where Parliament finds that is necessary to do so when there is a scarcity of goods. So, a clear ground was let down when such discriminatory legislation or discriminatory law shall be considered to be constitutionally aligned. Article 304 enables the State to impose non-discriminatory taxes on goods imported from other States and reasonable restrictions on inter-State trade commerce and intercourse in public interest. Article 305 talks about saving of existing law, pre constitutional law and Article 307 talks about appointment authority for the purpose of carrying out the purpose of Article 301 to Article 304. So, the arrangement of Article 301 to 303 you would find that it is a provision which is very much interconnected, where you find one provision is an exception to another and then again it is exception to another, but all this is been done with a clear idea of these three principles. One in larger public interest for economic unity of the country, it was suggested that there must be free flow of trade commerce and intercourse both inter-State and intra-State. Second principle says that regional interest must not be altogether ignored. So, space has been given to State to also cater its own interest, but then catering of that interest should not be at the cost of impeding trade and if that happens, Union can very well interfere.

So, regional autonomy was taken into account, the goal of free trade was taken into account and overall Parliament was allowed to interfere. So, you may say that that federal structuring here is also based on the idea of giving supremacy the Union Parliament. Now, this is what it says that there shall be free flow of trade throughout the territory of India, Article 301 says. When you read Article 302 it says Parliament is empowered to impose restrictions on such free trade between one States to another State, but then it has to be in public interest. Now, you can very well visualize that when it lays down a condition of enacting a law in the name of public interest, then necessary jurisdiction is conferred on the judiciary to examine such legislative measures taken by the Parliament under Article 302 that whether it is in public interest or not.

Article 303 further it says is an exception, where it says that restrictions on legislative power and Union and both the States. It says that you can bring a law, but then such law shall not discriminate, such law shall not give preference to one State over one another State that is what categorically it says. Neither Parliament nor the State Legislatures shall have the power to make any law by virtue of any Entry relating to trade and commerce in any of the Lists in Schedule VII. And what they are prohibited to do they cannot prefer one State over another, they cannot discriminate over one is State over another. There cannot be any discrimination between one State and another. So, you can very well see that this very design given modifies that classical federal understanding of giving exclusivity to the Centre or the Union on a particular subject matter.

So, Indian Constitution brings in this kind of design. It molds the requirement of economic prosperity and economic unity, where it says that yes there is a subject matter which is there with you in given in Schedule VI, but then invoking that you cannot make a law which would this would be discriminating between the States. Article 303(2) you would find is an exception again to Article 303(1) where it says that you can prefer or you can discriminate if it is connected with scarcity of goods. Here again you find there is a condition given for deviation, that deviation is allowed it can be approved only when it connects with scarcity of goods. So, though technically you find that Part XII is all about exceptions after exceptions, but then closer analysis says it is more of incorporating, it is more of a reflection of pragmatic approach on the issue of trade and commerce. Article 304 again is an exception to Article 302 and Article 303, because Article 302 allows Parliament to impose restriction in name of public interest, Article 303 says that you can do it when there is a scarcity of goods you can bring in preference or discrimination.

Now there again it says a State Legislature may by law 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. However, not so as to discriminate between goods so imported and goods so manufactured or produced. So, if a good is being imported from other State and it is also being manufactured in that State, then State is prohibited from creating a trade barrier for such imported goods. It would not be a case that that the State in order to promote domestic trade, domestic industry would be bringing discriminatory legislation that is something which is prohibited. Unless and until there is an exception given that the legislature of a State may by law

impose such reasonable restrictions on freedom of trade with or within that State as may be required in public interest for, but for doing so what is required is that that prior sanction is to be obtained from the President.

So, Article 302 allows Parliament to impose restriction in the name of public interest, Article 304 allows the State to impose restriction in the name of public interest, but for 304 it says that the prior sanction is to be obtained from the President. Another distinction is that under Article 302 there is no reference of the word reasonable which is in the case of Article 304. Now if you go into interpretation it does not matter because any initiative any measure taken by the Parliament under Article 302 in the name of public interest is also required to be reasonable. So, even if the word is missing there that would not make any impact on the issue of scrutinizing legislative measures of the Parliament. Article 305 gives legitimacy to the pre constitutional law unless and until the President may by order otherwise effects.

So, President here is obviously, is a case of Councils of Minister were saying otherwise pre constitutional law shall have a kind of prevalence. Now as I said that the idea of Article 301 to 307 is to create common market, to create economic unity because common market is about absence of obstacles and free flow of goods and services. Goods services and I would say even individuals are guaranteed under Article 19 when it comes to citizen, whereas for non-citizen Article 301 will come into play. As we know that Article 19 does not apply to State or Corporation, Article 301 would be applicable there. So, barrier free trade is stretched at the very base of regional biasness and is a based on the very idea that entire country is one unit. It is not to be seen as fragmented units for the purposes of trade and governments allow creating barriers that is something which is not the constitutional goal.

So, free trade it says movement of goods persons services and capital these are the foundation of common market and that is what is the idea underlying Article 301. So, clear cut attempt has been done under the Constitution that we need to achieve that economic unity. So, that development shall take place in a uniform way. So, that discriminatory barrier is not to be created by one State. So, that Parliament should not prefer one over another.

So, this is very clear when it comes to that and that is why generally it has been said that though

GST reform has already introduced the idea of common market by bringing in one nation one tax structuring. Otherwise it was earlier said that India before thinking of signing a free trade agreement with other countries India should first ensure that there is a free trade agreement amongst the federating units or amongst the constituent units. But now with GST regime that has been addressed to a large extent at least on the matter of indirect taxation. Otherwise prior to that there was a provision where different sales tax slab was there. So, one State would be having one slab for imposing for imposing tax on sale or purchase of the goods.

So, lot of variations were there and which in a way was creating a bottleneck between the between the constituent unit or between the States. Now, there is a difference between Australian positioning and Indian positioning because Australian position was somewhere related to between the States. In India it is not only between the States it is also within the States that is throughout the territory of India. So, throughout the territory of India means thereby both inter-State and intra-State. Now, this reference of Sarkaria Commission report is important because of the very fact that there is a dedicated chapter and in this report some of the provisions were examined in detail by the Committee and gave the suggestion.

For example, I said that there was a suggestion given by the States that let there be inclusion of word reasonable with Article 302 also, but then Sarkaria Commission said that when you analyse the way these measures are to be scrutinized then reasonableness has to be read because anyway any such measures would also be brought will also attract the applicability of Articles 14 and 19 and which certainly gets examined on the basis of gets examined on the basis of reasonableness. Then the Sarkaria Commission has said that the provisions are well balanced though it appears to be a provision full with exceptions, but when you go deeper into it you would find that it is all about looking at the larger national interest at the same time accommodating regional interest and also if required giving necessary power to the Centre to interfere, giving necessary power to Parliament to interfere in in the larger interest. Part XIII has been a subject matter of judicial scrutiny right after the commencement of the Constitution. Important cases have come under the scanner of the judiciary for example, *Atiabari Tea Co. Ltd. v. State of Assam*, *Automobile Transport (Rajasthan) Ltd. v. State of Rajasthan*, *Jindal Stainless Ltd. v. State of Haryana*. In *Atiabari Case* the court has said that whether a tax levied by a State shall be considered to be

creating a barrier or not. The court has said that we need to apply direct and immediate effect test because we need to understand that tax is an important source of revenue generation.

So, tax per say is not to be considered to be creating barrier unless and until it has an effect of creating barrier because in the absence of this understanding it will be very difficult to allow State to create to generate revenue. So, tax per say is not to be looked at validity of Article 301, but then Article 301 certainly brings within its ambit tax related legislative measures. So, if tax related legislative measures are creating barrier then certainly that can become a subject matter of scrutiny under Article 301. So, in Atiabari the court has some of with this idea of direct and immediate effect that whether directly such legislative measure is creating bottleneck if answer is yes then that is something which can be declared as unconstitutional by looking at the scheme of Part XIII of the Constitution. So, tax laws are governed under Part XI and Part XIII and restrictions should be such restrictions as directly and immediately restricting the free flow.

Taxes amount to restrictions only when such restrictions are direct and immediate otherwise it is not. Otherwise it would in a way it would make the revenue generation scope of the State as a very constraint one. So, that is not the idea underlying Part XIII that is what we need to understand. Then revisiting of Atiabari Case is done in Automobile Transport Case where the court has clarified the idea of compensatory tax. The court has said regulatory measures or measures imposing compensatory taxes for the use of trading facilities do not come within the purview of Article 301. In a way in an Automobile Transport Case, the court has said that when the State levies tax it is not to be always seen in a case of tax simpliciter sometimes those taxes are being also employed for providing better infrastructure, for facilitating trade which comes under the category of compensatory tax and that is something which cannot be violative of Article 301 and there is no need of going for taking prior approval from the President for levying such tax.

So, that was clarified. So, this is what the test led down to determine compensatory tax that whether it is to facilitate trade, for better conduct of trade. Then again the court in Jindal Stainless Case clarified that tax is imposed as a part of regulation or regulatory measure and then it is not to be seen as a burden. It is to be seen as that what kind of benefit it is going to giving to the trader or giving to the entire business. But then this idea of compensatory tax has come under

heavy criticism because it was argued that there is no constitutional basis of compensatory tax from where the judiciary is legitimizing this idea of compensatory tax and therefore, the matter was referred to a larger bench. In 2017 9-judge bench of Jindal Stainless Case categorically said that there is nothing called compensatory tax. There is a no reference of compensatory tax under the Constitution for the purpose of Article 301. Court says that taxes simpliciter are not within the contemplation of Part XIII of the Constitution.

So, categorically what it means that free trade does not mean free from taxation that is not the idea. By the same time such taxes shall not be creating barrier that is what it needs to be seen. So, for that purpose the judgment given on compensatory tax in Atiabari and Automobile Transport or Jindal Stainless (2006) these cases were overruled in 2017 of Jindal Stainless Limited. Now, another important thing that when you look at the scheme of Article 301 to 304 you would agree that it is a scheme where economic unity is a goal, but to achieve that goal it requires lot of dialogue, lot of coordination, lot of collaboration between the parties, between the States, between the Center and the States. And therefore, in a way it requires a sort of expertise, dedicated domain with a clear responsibility to do to attain the objective under Part XIII of the Constitution. That's what the futuristic approach of the makers of the Constitution.

They were aware of the fact that creating economic unity is an important goal to achieve and there should not be any delay on that. And that is why they provided for creating an authority for the purpose of carrying out and achieving the goal laid down under Part XIII in Article 307. They said that Parliament shall establish an authority for the purpose of achieving the goal laid down in Part XIII. Because they are aware of the fact that political unity is not good enough. You also have to look into the economic unity and for economic unity the practices of States looking at their own interest States promoting parochial interest would not be advisable.

And that is why they suggested that let there be an authority made created by established by Parliament for addressing those issues. Because those issues are of a different kinds you need to go talk to the State representative that what is making them to revise the tax, why they are thinking that their industry is not going to get promoted if there is an import happening. So, all these subject matters require a kind of closer coordination between the constituent units and that is why they provided for the same. Now, unfortunately what we find is that till date no authority

has been established and in fact, some of the reports have negated also the need of such authority. I would say that it is a need of the hour to come up with such authority because when makers have thought about having such authority they were very clear that why this authority is required and why Part XIII becomes very pertinent for strengthening federal relation in India.

It was very clear that that this this authority would be playing a vital role in clarifying the differences between the States. It will play an instrumental role in building a close coordination between the Centre and the States or amongst the States, but unfortunately no authority has been established till date. Sarkaria Commission suggested the creation of a constitutional body under Article 377. Sarkaria Commission suggested that an expert body to formulate objective views taking into account the long term perspective in regard to various intricate is been done. NCRWC also suggested for setting up Inter-State Trade Commerce Commission under Article 307. Punchhi Commission also said that interstate trade and commerce with both advisory and executive roles. So, suggestions have come, but then Parliament has not acted upon it, unfortunately no Commission or no authority has been established in pursuant to Article 307. When you look at it as I said that the there is an Inter-State Council, but then Inter-State Council has a defined task under the Constitution whereas Article 307, the authority what Article 307 refers to, it has a defined one where it talks about horizontal relationship between the States and it also talks about strengthening cooperative federalism where they need to come together.

So, that is what is important to look at. These are the references for this session. Thank you very much.