

# Constitutional Aspects of Indirect Taxes

Session at Certificate Course on Indirect Taxes organized by  
The Indirect Taxes Committee,  
The Institute of Chartered Accountants of India  
Bhopal

19 October 2013

By Advocate Anil Chawla  
(B.Tech. LL.B.)  
Senior Partner,  
Anil Chawla Law Associates LLP  
[www.indialegalhelp.com](http://www.indialegalhelp.com)

# A Problem to Ponder

कृपया म0प्र0 मनोरंजन शुल्क एवं विज्ञापन कर (संशोधन) अधिनियम 2009, का अवलोकन करने का कष्ट करें। म0प्र0 मनोरंजन शुल्क एवं विज्ञापन कर अधिनियम 1936 की धारा - 3 की उपधारा (1) के अधीन आपकी मोबाइल कंपनी द्वारा मोबाइल फोन पर Value added मनोरंजन सेवा पर प्रभारित/ वसूल की गयी राशि पर, 20 प्रतिशत की दर से मनोरंजन शुल्क देय है जिसे आपके द्वारा मुख्य राजस्व शीर्ष 0045, वस्तुओं एवं सेवाओं पर कर मद में अग्रिम जमा नहीं कराया जा रहा है साथ ही पंजीकृत उपभोक्ताओं की संख्या, प्रभारित की जाने वाली मासिक राशि एवं देय मनोरंजन शुल्क आदि से संबंधित वांछित जानकारी, सुसंगत लेखा एवं अभिलेख, मोबाइल फोन सेवा पर Value added मनोरंजन सेवा प्रदाता द्वारा सेवा प्रारंभ किये जाने के दिनांक के 31 जुलाई 09 तक की अवधि में माह दार प्रस्तुत नहीं किये जा रहे हैं अतः आप मोबाइल फोन पर Value added मनोरंजन सेवा में पंजीकृत उपभोक्ताओं से प्रभारित/ वसूल की गई राशि पर 20 प्रतिशत की दर से देय मनोरंजन शुल्क, मुख्य राजस्व शीर्ष 0045, वस्तुओं एवं सेवाओं पर कर मद में प्रतिमाह नियमित रूप से अग्रिम जमा करें तथा संबंधित अभिलेख पत्र प्राप्ति के सात दिवस में कार्यालय में प्रस्तुत करें।

## Right to Impose Taxes

**265.** No tax shall be levied or collected except by authority of law.

Note: Article 265 applies only to tax and not fees.

**14.** The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India.

**300A.** No person shall be deprived of his property save by authority of law.]



# Tax vs. Fees

'Fees' are the amounts paid for a privilege, and are not an obligation, but the payment is voluntary. Fees are distinguished from taxes in that the chief purpose of a tax is to raise funds for the support of the Government or for a public purpose,

(1) there should be relationship between service and fee,

(2) that the relationship is reasonable cannot be established with mathematical exactitude in the sense that both sides must be equally balanced,

(3) in the course of rendering such services to the payers of the fee if some other benefits accrue or arise to Others, quid pro quo is not destroyed. The concept of quid pro quo should be judged in the context of the present days ' a concept of markets which are expected to render various services and provide various amenities, and these benefits cannot be divorced from the benefits accruing incidentally to Others,

(4) a reasonable projection for the future years of practical scheme is permissible, and

(5) services rendered must be to the users of those markets or to the subsequent users of those markets as a class. Though fee is not levied as a part of common burden yet service and payment cannot exactly be balanced.

(6) The primary object and the essential purpose of the imposition must be looked into.

Southern Pharmaceuticals and Chemicals, Trichur and Ors. (1981) SCC 391 and I.T.C. Ltd. v. State of Karnataka (1985) SCC 476 quoted by SC in Bangalore Development Authority vs. The Air Craft Employees Cooperative Society Ltd. and Ors. MANU/SC/0053/2012

# Division of Powers

246. (1) Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule (in this Constitution referred to as the "Union List").

(2) Notwithstanding anything in clause (3), Parliament, and, subject to clause (1), the Legislature of any State <sup>1\*\*\*</sup> also, have power to make laws with respect to any of the matters enumerated in List III in the Seventh Schedule (in this Constitution referred to as the "Concurrent List").

(3) Subject to clauses (1) and (2), the Legislature of any State <sup>1\*\*\*</sup> has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule (in this Constitution referred to as the "State List").

Article 246 makes it clear that the exclusive powers conferred on the Parliament or the States to legislate on a particular matter includes the power to legislate with respect to that matter. Hence where the entry describes an object of tax, all taxable events pertaining to the object are within that field of legislation unless the event is specifically provided for elsewhere under a different legislative head. Where there is the possibility of legislative overlap, courts have resolved the issue according to settled principles of construction of entries in the legislative lists.

# Residuary Powers

248. (1) Parliament has exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or State List.

(2) Such power shall include the power of making any law imposing a tax not mentioned in either of those Lists.

97. Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists.



## No Overlap between Union and State

"A scrutiny of Lists I and II of the Seventh Schedule would show that there is no overlapping anywhere in the taxing power and the Constitution gives independent sources of taxation to the Union and the States. Following the scheme of the Government of India Act, 1935, the Constitution has made the taxing power of the Union and of the States mutually exclusive and thus avoided the difficulties which have arisen in some other Federal Constitutions from overlapping powers of

No taxation powers are in Concurrent List.

# Limit of Professional Tax

276. (1) Notwithstanding anything in article 246, no law of the Legislature of a State relating to taxes for the benefit of the State or of a municipality, district board, local board or other local authority therein in respect of professions, trades, callings or employments shall be invalid on the ground that it relates to a tax on income.

(2) The total amount payable in respect of any one person to the State or to any one municipality, district board, local board or other local authority in the State by way of taxes on professions, trades, callings and employments shall not exceed <sup>1</sup>[two thousand and five hundred rupees] per annum.



# Union List Items of Indirect Taxation

22. Railways.

23. Highways declared by or under law made by Parliament to be national highways.

42. Inter-State trade and commerce.

83. Duties of customs including export duties.

84. Duties of excise on tobacco and other goods manufactured or produced in India except—

(a) alcoholic liquors for human consumption;

(b) opium, Indian hemp and other narcotic drugs and narcotics,

but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

85. Corporation tax.

## Union List Items of Indirect Taxation (Continued)

86. Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies.

87. Estate duty in respect of property other than agricultural land.

88. Duties in respect of succession to property other than agricultural land.

89. Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights.

90. Taxes other than stamp duties on transactions in stock exchanges and futures markets.

91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

# Union List Items of Indirect Taxation (Continued)

92. Taxes on the sale or purchase of newspapers and on advertisements published therein.

<sup>1</sup>[92A. Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.]

<sup>2</sup>[92B. Taxes on the consignments of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce.]

\*[92C. Taxes on services.]

96. Fees in respect of any of the matters in this List, but not including fees taken in any court.

<sup>1</sup>Ins. by the Constitution (Eighty-eighth Amendment) Act, 2003, s. 4 (which is yet not in force, date to be notified later on).



# State List Items of Indirect Taxation

8. Intoxicating liquors, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors.

13. Communications, that is to say, roads, bridges, ferries, and other means of communication not specified in List I; municipal tramways; ropeways; inland waterways and traffic thereon subject to the provisions of List I and List III with regard to such waterways; vehicles other than mechanically propelled vehicles.

17. Water, that is to say, water supplies, irrigation and canals, drainage and embankments, water storage and water power subject to the provisions of entry 56 of List I.

18. Land, that is to say, rights in or over land, land tenures including the relation of landlord and tenant, and the collection of rents; transfer and alienation of agricultural land; land improvement and agricultural loans; colonization.

34. Betting and gambling.

## State List Items of Indirect Taxation (Continued)

49. Taxes on lands and buildings.

50. Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.

51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:—

(a) alcoholic liquors for human consumption;

(b) opium, Indian hemp and other narcotic drugs and narcotics;

but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

## State List Items of Indirect Taxation (Continued)

52. Taxes on the entry of goods into a local area for consumption, use or sale therein.

53. Taxes on the consumption or sale of electricity.

<sup>1</sup>[54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.]

55. Taxes on advertisements other than advertisements published in the newspapers <sup>2</sup>[and advertisements broadcast by radio or television].

56. Taxes on goods and passengers carried by road or on inland waterways.



## State List Items of Indirect Taxation (Continued)

57. Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tramcars subject to the provisions of entry 35 of List III.

58. Taxes on animals and boats.

59. Tolls.

60. Taxes on professions, trades, callings and employments.

61. Capitation taxes.

62. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

63. Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.

# Illustrative Case

Appellants: **Godfrey Phillips India Ltd. and Anr.**  
**Vs.**

Respondent: **State of U.P. and Ors.**

## **Uttar Pradesh Tax on Luxuries Act 1995**

"Levy of luxury tax.--Every tobacconist shall be liable to pay luxury tax on his turnover of "receipts" at such rate, not exceeding twenty five per cent, as the State Government may, by notification, specify and different rates may be specified for different classes of tobacco:

Provided that a "tobacconist" who does not manufacture or receive tobacco from outside the State shall be liable to pay tax on his turnover of receipts from the date his turnover of receipts exceeds two lakh rupees:

Provided further that in a chain of supply of tobacco, the tax shall be realized from the earliest of the "tobacconists" in the State and a successive "tobacconist" shall be exempt from payment of tax if he furnishes, in the manner prescribed, proof of payment of tax on such tobacco."

## Illustrative Case (Continued)

23. According to Mr. Harish Salve, appearing for some of the assesseees, the word "luxuries" could not be construed to mean goods and the State's power to legislate in respect of luxuries under Entry 62 of List II of the Seventh Schedule to the Constitution did not extend to tax the sale, manufacture, or import of any goods. It is submitted that a tax on goods would have to mean a tax on some facet of the goods commencing with its manufacture and ending with its consumption. Taxation on each and every facet of goods had been specifically provided for in the legislative lists in the Seventh Schedule. For example excise duty on the manufacture of goods is covered under Entry 84 of List I, tax on the sale of goods is covered by Entries 92-A and 92-8 of List I and Entry 54 of List II and duties on import and export of goods were referable to Entry 83 of List I. In each of these cases higher rates of tax were charged or duty levied when the commodities in question were of higher value. According to Mr. Salve if the word 'luxuries' in Entry 62 were construed to include goods, then it would allow the State to legislate on all these several facets merely by describing the goods as luxuries. Similarly if the word 'luxuries' was to be understood as descriptive of goods it would mean that the entry would give the State over-riding power to levy tax on all goods and would disturb the scheme of distribution of power on taxation and collection of revenue envisaged under the Constitution. It



## Illustrative Case (Continued)

24. Mr. K.K. Venugopal also appearing for the assessee submitted that the language in Entry 82 List II read "taxes on luxuries including entertainment etc." it is submitted that the word "including" should, in the context, be interpreted as illustrative. therefore, on the principle of *noscitur a sociis*, "luxury" would have to mean something in the nature of entertainments, amusements, betting and gambling. The argument is also that Entry 62 of List II uses two phrases, namely, 'tax on luxury' and 'tax on entertainment, amusements, betting and gambling'. There are, therefore, two kinds of taxes envisaged under the entry. The clubbing together of these two kinds of taxes would indicate that this was done because of a common element in the nature of the taxes to be imposed, the link being that both referred to a kind of activity. Mr. Venugopal also submitted that the tax sought to be imposed under the West

## Illustrative Case (Continued)

26. Mr. M. Parasaran, representing the Union of India, supported the contentions of the assesses and has submitted that the luxury tax in U.P., A.P. and W.B. was in fact a tax on the sale and purchase of tobacco and that the levy of the tax was contrary to the scheme of collection and distribution of taxes under which the center alone may levy taxes on goods declared to be of special importance.

27. Mr. S. Gupta representing the State of Uttar Pradesh has submitted that the word 'luxury' has been defined authoritatively in **Abdul Kadir** (supra) as, "something which conduces enjoyment over and above the necessities of life. It denotes something which is superfluous and not indispensable and to which we take with a view to enjoy, amuse or entertain ourselves". It is submitted that this definition should not be cast aside since it had held the field for several decades. According to Mr. Gupta, the object of a luxury tax is the occurrence or event of luxury which itself means, "the happening of indulgence, extravagance, pleasure, comfort, gratification of the senses etc.". It is submitted that the word 'luxury' was applicable both to commodities and services and that this has been expressly held in **Express Hotels v.**

## Illustrative Case (Continued)

44. Classically, a tax is seen as composed of two elements: the person, thing or activity on which the tax is imposed and the incidence of tax. Thus every tax may be levied on an object or an event of taxation. The distinction between the two may not, ultimately, be material in the

45. An illustration of this distinction is nicely brought out in **State of Karnataka v. Drive-in-Enterprises** MANU/SC/0166/2001 : [2001]2SCR378 . Entertainment tax was levied by the Karnataka Cinemas (Regulation) Act, 1964 and the Rules framed thereunder by the State in respect of a film show. A higher rate of tax was levied on persons who drove their cars in to view the film from the comfort of their cars. The challenge to the Act was the entertainment tax could be levied only on human beings and not on any inanimate object, namely motor vehicles. The challenge was negated on the ground that the State was competent to levy tax on entertainment under Entry 62 List II. That was the subject matter of the tax. The incidence of the tax was on the persons entertained. Clearly the manner in which the burden would fall viz. on persons either with or without motor vehicles would not affect either the object or the nature of the tax. Motor vehicles were neither the object of taxation nor the taxable event but were part of the incidence of the tax.



## Illustrative Case (Continued)

47. The first of such settled principles is that legislative entries should be liberally interpreted, that none of the items in the list is to be read in a narrow or restricted sense and that each general word should be held to extend to ancillary or subsidiary matters which can fairly and

50. The argument of Mr. Salve is in fact that the breadth of an entry is curtailed by the second principle of construction. The second principle is that competing entries must be read harmoniously. The proper way to avoid a conflict would be to read the entries together and to interpret the language of one by that of the other (**Governor General in Council v. Province**

## Illustrative Case (Continued)

65. No State can therefore by describing an item as a luxury, seek to levy tax on its supply. It cannot be disputed that as far as UP and AP are concerned, were it not for their Interpretation of Entry 62 of List II, the tax would be referable only to Entry 54 List II. If Entry 62 List II does not allow the taxation of goods, the levy would not be constitutionally sustainable.

66. In our opinion to read Entry 62 List II as including articles of luxury cannot allow all these constitutional restrictions to be by-passed allowing States to levy tax on the supply of goods by describing them as luxury goods. As has been rightly contended by Mr. Parasaran appearing for the Union of India, the supply of luxury is nothing but the supply of goods since the goods themselves constitute the luxury.

67. So even if tobacco is an article of luxury, a tax on its supply is within the exclusive competence of the State but subject to the constitutional curbs prescribed under Article 286 read with Sections 14 and 15 of the Central Sales Tax Act, 1956 and most importantly the ADE Act of 1957 under which no sales tax can be levied on tobacco at all if the State was to take the benefits under that Act.

## Illustrative Case (Continued)

whether the language of Entry 62 List II would resolve the issue. The juxtaposition of the different taxes within Entry 62 itself is in our view of particular significance. The entry speaks of "taxes on luxuries including taxes on entertainments, amusements, betting and gambling". The word "including" must be given some meaning. In ordinary parlance it indicates that what follows the word "including" comprises or is contained in or is a part of the whole of the word preceding. The nature of the included items would not only partake of the character of the

71. It has also been held that the word 'includes' may in certain contexts be a word of limitation (**South Gujarat Roofing Tiles Manufacturers v. MANU/SC/0314/1976 State of Gujarat** : [1977]1SCR878 . In the context of Entry 62 of List II this would not mean that the word 'luxuries' would be restricted to entertainments, amusements, betting and gambling but would only emphasise the attribute which is common to the group. If luxuries is understood as meaning something which is purely for enjoyment and beyond the necessities of life, there can be no doubt that entertainments, amusements, betting and gambling would come within such understanding. Additionally, entertainments, amusements, betting and gambling are all activities. 'Luxuries' is also capable of meaning an activity and has primarily and traditionally been defined as such. It is only derivatively and recently used to connote an article of luxury. One can assume that the coupling of these taxes under one entry was not fortuitous but because of these common characteristics.



## Illustrative Case (Continued)

72. Where two or more words are susceptible of analogous meaning are clubbed together, they are understood to be used in their cognate sense. They take, as it were, their colour from and are qualified by each other, the meaning of the general word being restricted to a sense analogous to that of the less general. As said in **Maxwell on the interpretation of Statutes** 12<sup>th</sup> Edn. P.289.

"Words, and particularly general words, cannot be read in isolation; their colour and their content are derived from their context, A-G v Prince Ernest Augustus of Hanover (1957) AC 436, per Viscount Simonds, at 461."

Noscitur A Sociis

## Illustrative Case (Continued)

80. Hence on an application of general principles of interpretation, we would hold that the word 'luxuries' in Entry 62 of List II means the activity of enjoyment of or indulgence in that which is costly or which is generally recognized as being beyond the necessary requirements of an average member of society and not articles of luxury.

91. Given the language of Entry 62 and the legislative history we hold that Entry 52 of List II does not permit the levy of tax on goods or articles, in our judgment, the word "luxuries" in the Entry refers to activities of indulgence, enjoyment or pleasure in as much as none of the impugned statutes seek to tax any activity and admittedly seek to tax goods described as luxury goods, they must be and are declared to be legislatively incompetent. However following the principles in

# Entertainment Tax on Value Added Services

- Value Added Services provided as part of mobile telephone services are exclusively covered by Entry 31 of List I Union List of Seventh Schedule.
- Taxation of services is under exclusive power of the Union of India under Entry No. 97 of List I Union List of Seventh Schedule of the Constitution



# Entertainment Tax on Value Added Services

- Value Added Services provided as part of mobile telephone services are exclusively covered by Entry 31 of List I Union List of Seventh Schedule.
- Taxation of services is under exclusive power of the Union of India under Entry No. 97 of List I Union List of Seventh Schedule of the Constitution
- There can be no justification for treating them under Entry 62 of List II State List of Seventh Schedule (Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling). Hence, the Legislature of state of Madhya Pradesh has no power under the Constitution to legislate in the matter of Value Added Services

## Entertainment Tax (Continued)

- Petitioner is supported in his contention by the judgment of Honourable Supreme Court in the matter of Godfrey Phillips (I) Ltd. & Anr. vs. State of U.P. & Ors. (2005 AIR 1103, 2005 (1) SCR 732).
- The well-established principle of law is that “pith and substance” or true nature (and not any one attribute or quality) of an activity or goods or service has to be seen before deciding the legal category to which it belongs. For example, the Honourable Supreme Court has opined that a luxury vehicle is to be taxed as a vehicle and not as a luxury. A state legislature cannot levy luxury tax on a luxury vehicle. Similarly, when children go to school, the primary and essential activity is education. It will be beyond the legal competence of a state legislature to levy entertainment / luxury tax on children going to school irrespective of the facts that the children have great fun in school or that the school is a very expensive one where only the super-rich can afford to send their children.



## Entertainment Tax (Continued)

- In case of value added services on mobile phones, the true nature / pith and substance is communication, while entertainment, if any, is purely incidental and non-essential. Hence, the state legislature has no legal competence to impose any tax on value added services.
- The principle of pith and substance has been accepted by courts even when interpreting with reference to The M.P. Entertainments Duty and Advertisements Tax Act, 1936. In the matter of Calico Mill Limited vs. State of M.P. (AIR 1961 MP 275: 1961 MP LJ 474: 1961 JIJ 376) the Honourable High Court faced a question whether a fashion show (where the admission was for Rs. 2 each) organized for promoting sale of clothes of the petitioner was an entertainment. The Honourable High Court held that the primary and essential purpose of the show was sale of goods and any entertainment that happened there was incidental; therefore the fashion show could not be labeled as an entertainment and no entertainment tax was leviable on the same.



## Entertainment Tax (Continued)

- It has been held that the primary purpose of a museum is enhancement of knowledge and not entertainment; and hence no entertainment tax can be levied on museum entry fees.
- If the logic of taxing on the basis of effect on the minds of customers is extended to its extreme limit, a day may come when customers may be charged entertainment tax on their telephone conversations based on the content of the talk that they had on the phone - if a caller tells a joke to his friend on the other end he will be charged entertainment tax on the conversation.
- Section 2(b) of M.P. Entertainments Duty and Advertisements Tax Act, 1936 does not mention being entertained or not being entertained as a criterion for levy of tax. Just as a film that is extremely boring cannot be exempted from payment of entertainment tax on ground of absence of entertainment, there can be no justification for levy of entertainment tax on any service or activity on the ground that the service or activity caused entertainment.

## Concluding Remarks

- Never assume that just because a tax is imposed by Parliament, State Legislature or Municipal body, it is constitutionally valid.
- Governments have an ever-increasing appetite. So they keep thinking of innovative ways to remove money from common man's pocket. In their enthusiasm, they often make mistakes.
- Constitution of India has many safeguards to limit the powers of various governments with regard to imposition of taxes.
- It is the duty of chartered accountants, tax professionals, advocates and vigilant citizens to keep check on governments.

# Thanks!

Hope that you did not get bored  
and that it was useful!

*Anil Chawla Law Associates LLP*

[www.indialegalhelp.com](http://www.indialegalhelp.com)

[info@indialegalhelp.com](mailto:info@indialegalhelp.com)

Tel. – 09425009280