(2015) 01 CHH CK 0039

In the Chhattisgarh High Court

Case No : Writ Petition (T) Nos. 143 to 150 of 2014

Pasa Associates Private Limited — APPELLANT

Vs

State of Chhattisgarh and Others — RESPONDENT

Date of Decision : 09-01-2015

Acts Referred:

Central Sales Tax Act, 1956 — Section 14, 14(iv)(iv)
Constitution of India, 1950 — Article 14, 301, 302, 303, 304
Evidence Act, 1872 — Section 106

Citation : (2015) 85 VST 439

Hon'ble Judges : Navin Sinha, Actg. C.J. and Pritinker Diwaker, J.

Bench : Division Bench

Advocate : Arvind P. Datar, Senior Advocate assisted by Lalit K. Ahluwalia and Neelabh Dubey, for the Appellant; Prafull N. Bharat, Additional Advocate-General, for the Respondent

Judgement

Navin Sinha, Actg. C.J.

1. The petitioners challenge notification dated May 30, 2014 under section 15B of the Chhattisgarh Value Added Tax Act, 2005 (hereinafter called "the VAT Act"). It levies a concessional rate of three per cent tax only under the VAT Act on steel bars (excluding in coil form) and steel structural as defined in section 14(iv)(iv) and (v) of the Central Sales Tax Act, 1956 (hereinafter called "the Central Act") on manufacture within the State by a small or medium scale industrial unit with total capital investment in plant and machinery not exceeding ten crores before depreciation up to March 31, 2014, and industrial units commencing production on or after April 1, 2014 up to date of commercial production. This benefit of tax concession has also been extended to a dealer registered under the VAT Act if he has purchased from such manufacturer and also extends the benefit to a second registered dealer purchaser. A concessional rate of tax at four per cent only on the two items has also been extended to other manufacturers in the State whose total capital 2015] Pasa Associates v. State of Chhattisgarh (Chhattisgarh) 443 investment in plant and machinery does not exceed ten crores before

depreciation up to March 31, 2014, and industrial units commencing production on or after April 1, 2014 up to date of commercial production. The normal rate of tax payable under the VAT Act for manufacturers outside the State and others within the State but outside the two exempted categories is five per cent.

2. The first ground of challenge to the notification is that it contravenes articles 301 and 304(a) of the Constitution of India, as it hinders freedom of inter-State trade and commerce by putting manufacturers outside the State of Chhattisgarh at a disadvantage by having to pay five per cent tax thus making their goods more expensive and uncompetitive directly affecting and impeding the inflow of outside goods into the State.

3. The second ground of challenge is by persons manufacturing in the State falling outside the two exempted categories, alleging arbitrariness and hostile discrimination, impermissible sub-classification, and absence of any rationale for such classification having nexus with any object to be achieved.

4. The learned senior counsel Shri Datar, appearing on behalf of the petitioners submitted that on March 30, 2013 the respondents issued a notification under section 15B of the VAT Act levying a flat rate of three per cent tax only on steel bars (excluding in coil form) and steel structural under section 14(iv)(iv) and (v) of the Central Act for the period April 1, 2013 to March 31, 2014. Section 14 of the Central Act contained sixteen different categories of iron and steel products. The respondents thus granted a product specific exemption to all dealing in the aforesaid items irrespective of manufacture inside or outside the State, whether it was a small and medium scale unit, with no investment limit.

5. By a subsequent notification dated March 4, 2014 under section 15B of the VAT Act, the earlier product specific exemption notification was now confined to three per cent concessional tax on the two items to manufacturers within the State only and which were a small and medium scale industrial unit in which up to March 31, 2014 or after April 1, 2014 till date of production the total investment in plant and machinery before depreciation did not exceed ten crores. The period of exemption was extended from March 31, 2014 to March 31, 2015. The rate of tax for manufacturers outside the State and other manufacturers in the State remained at five per cent.

6. The impugned notification dated May 30, 2014 was then issued. Retaining the concessional rate of tax at three per cent for small and medium scale units manufacturers within the State, the benefit was now also extended to a registered dealer purchasing from such manufacturer and also to a subsequent purchaser from such registered dealer purchaser. An additional benefit of four per cent concessional tax was also extended to those manufacturers within the State whose investment did not exceed ten crores as specified and also to registered purchasers from such manufacturer or the subsequent purchaser also. The extension of concessional tax to a purchaser from the manufacturer and to the subsequent purchaser also in both categories were assailed as being completely

unsustainable, entering into the arena of pure commercial transactions having no nexus with providing impetus to industrialization. The tax on manufacturers outside the State was kept at five per cent putting them at great disadvantage making their products costlier and uncompetitive directly affecting the inflow of those goods from outside the State thereby impeding and hindering inter-State trade and commerce. It was submitted that Parliament alone was competent under article 302 of the Constitution to impose restrictions on inter-State trade in public interest.

7. Shri Datar further submitted that of the sixteen items of iron and steel products under section 14 of the Central Act, there was no basis or justification for classification of two class of goods only for concessional rate of tax to the specified categories only, and how it alone would give the desired impetus to industrialization in the State. Under section 15B of the VAT Act exemption could be granted only to any class of dealers, to any goods or class of goods. The first notification dated March 30, 2013 was valid as it partly exempted a whole class of goods being steel bars (excluding in coil form) and steel structural. The subsequent sub-division of the two goods based on investment limit and manufacture by a small and medium scale unit and extending it to purchasers from the same and to second purchasers was impermissible under section 15B of the VAT Act, as class of dealers shall mean dealers registered under the VAT Act dealing with the same class of products. The notification was therefore ultra vires section 15B of the VAT Act.

8. The learned senior counsel Shri Datar next submitted that no material has been placed by the respondents to show how and in what manner the State Government had applied its mind to arrive at the conclusion that while subjecting others to five per cent tax the grant of tax concession to these two categories only and confined to the identified categories of products alone would give the desired impetus to industrialisation and boost the State economy. No material had also been placed to demonstrate on what basis this differential rate of concessional tax at three per cent and four per cent was arrived at and what was the basis of fixing one per cent differential tax between them along with how it would achieve the desired result of boosting the State economy. No data had been placed of the number of units in each category and those outside it within the State and what benefits had been reaped since the new tax regime was introduced.

9. Shri Datar further submitted that that the "effect of law" test shall have to be applied in considering if the tax concession granted contravened article 304(a) . The twin test of "imposition" and "subjecting" to tax will have to be applied. Even if there has been no imposition of higher rate of tax on similar goods from outside the State, but if grant of concessional tax on goods inside the State puts those from outside the State at a disadvantage resulting in subjecting them to a higher rate of tax than the goods manufactured in the State, effectively it amounts to imposition of tax at higher rate on goods imported into the State,

prohibited by the Constitution. If the tax structure affects the inflow of goods from outside the State article 304(a) would stand contravened. What could not be done directly cannot be permitted to be done indirectly.

10. Reliance was placed on Anand Commercial Agencies Vs. The Commercial Tax Officer VI Circle, Hyderabad and Others, in support of the submission that the consistent view has been that a State is not entitled to tax locally made goods at a lower rate while taxing similar goods manufactured in other States at a higher rate.

11. Shri Datar relied on State of U.P. and Others Vs. Jaiprakash Associates Ltd., to submit that grant of a concessional rate of tax would contravene article 304(a) putting manufacturers outside the State at a disadvantage making their products expensive and uncompetitive affecting the inflow of their goods into the State. Article 304(a) ensures equality of tax for incoming goods. If incoming goods are taxed at a different rate from indigenous goods or the latter is given a concessional rate of tax article 304(a) stands violated as it naturally affects inter-State trade, commerce and intercourse by impeding inflow of outside goods into the State.

12. Elaborating further Shri Datar contended that a concession in tax had the effect of a reduced rate of tax. If the rebate or concession is granted on the full amount of the tax levied on any specific point extended to the limits of the State only, with the State Government having power to refund or discount the value rate of tax provided to the dealer then only it would not amount to discrimination between goods imported and manufactured in the State under article 304(a) .

13. Assailing the notification on behalf of those manufacturing inside the State but falling outside the two exempted categories, as being violative of article 14 of the Constitution, it was submitted that there would be a presumption with regard to the legality of the notification. But if the petitioners are able to create a doubt with regard to the correctness and legality on the touchstone of the Constitution, the onus and burden to demonstrate legality and constitutionality would shift to the respondent-State. No material had been placed by the respondents of any study or survey carried out, in what manner grant of concession on the two items only limited to the two specified categories of manufacturers and purchasers from them with a one per cent difference in tax between them, was sufficient to provide boost for industrialization of the State. No empirical data had been placed with regard to the number of units in the two categories within the State/their market share as compared to others manufacturing within the State to conclude that the former alone were sufficient to provide the needed boost to economic growth, and how it may or may not affect those manufacturing within the State but falling outside the categories granted concession. The grant of a concession has to be based on certain data reflecting aims and objects in the form of policy identifying items and persons as necessary and sufficient for growth. Invoking section 106 of the Evidence Act it was submitted that these were facts specifically within the knowledge of the State authorities and the onus

lay on them to provide the empirical data. The bald contention of the respondents in the counter-affidavit that a reasonable classification had been made keeping in mind the industrial backwardness of the State or that industries would not come or would shift out of the State, if such concession was not granted was insufficient if the classification-made, was irrational not based on intelligible differentia, to distinguish those within the group from those outside. Indeed it was a sub-classification clearly impermissible under the Constitution.

14. Shri Prafull N. Bharat, Additional Advocate General, appearing on behalf of the State submitted-.that the State was rich in natural resources but was otherwise a backward State. The need was felt to provide incentive to small and medium scale industries and to industries having an investment up to 10 crores, by grant of a concessional rate of tax for a limited period on specified items, to give an impetus to industrialization in the State. The concession was motivated to spur accelerated industrial growth. It was not intended to be a concession in a permanent form. Article 304(a) was not attracted as there has been no imposition of higher tax on goods imported into the State as compared to similar goods manufactured inside the State. A concessional rate of tax had only been provided for specified categories of manufacturers in the State of the two products.

15. It was next submitted that the intention of a taxation provision is to be gathered from the language of the notification only especially if it is plain and unambiguous. The economic result is not relevant in interpreting a fiscal notification. Words cannot be added or substituted to the notification. The three components for a valid tax was the subject of tax, the person liable to pay the tax and the rate at which it is to be paid. All three conditions stand fulfilled under the impugned notification. There was no illegality in the same. Reliance was placed on Mathuram Agrawal Vs. State of Madhya Pradesh, .

16. Shri Bharat next relied upon Video Electronics Pvt. Ltd. and Another and Weston Electronics Ltd. and Another Vs. State of Punjab and Another, . He submitted that after considering Firm A.T.B. Mehtab Majid and Co. Vs. State of Madras and Another, it was held in the former that the concept of economic unity of States was a changing concept and had to be interpreted in a manner permitting concession/exemptions to allow backward States to become economically developed. The power to grant exemption is based on natural and business factors not having any intentional bias based on cogent and intelligible reasons to encourage social and economic growth and that too by grant of exemption for limited period on certain specific conditions. It would not violate article 301 or 304(a) of the Constitution. A concession not being an imposition would stand excluded from article 304(a) of the Constitution as it does not impede or restrict freedom of inter-State trade and commerce by preventing manufacturers outside the State of the aforesaid two items from selling their products in the State of Chhattisgarh. The ultimate object of the Constitution is to develop the economic unity of India spread across all States with an equal

opportunity of growth and which is what the impugned notification purports to do.

17. Sri Bharat submitted that the concession granted did not violate article 301 or 304(a) of the Constitution as those manufacturing outside the State were not prohibited from selling within the State and neither could it be said that the concession was of a nature directly and immediately impeding movement of goods inter-State relying on The State of Kerala Vs. A.B. Abdul Kadir and Others, and Vrajlal Manilal and Co. and Another Vs. State of M.P. and Another, . The grant of concession in tax to local manufacturers could not ipso facto be considered as impeding inter-State trade and commerce for which reliance was placed on Shree Digvijay Cement Co. Ltd. and Others Vs. State of Rajasthan and Others, .

18. Reliance was next placed on Shree Mahavir Oil Mills and Another Vs. State of Jammu & Kashmir and Others, to submit that Video Electronics Pvt. Ltd. and Another and Weston Electronics Ltd. and Another Vs. State of Punjab and Another, was also noticed and followed therein as also in State of U.P. and Others Vs. Jaiprakash Associates Ltd., .

19. Shri Bharat further contended that there has been no hostile discrimination under article 14 of the Constitution as the three categories of manufacturers inside the State, small and medium industrial units, those having investment up to ten crores and those manufacturing in the State but falling outside the aforesaid two categories constituted separate classes. The former two required support while the latter did not. There shall be a presumption that the State Government had duly applied its mind to all aspects of the matter, considered all issues and arrived at the conclusion that the nature of incentive or concession granted was required for spurring economic and social growth. If the petitioners contend that such concession would not spur economic growth or was not necessary for the purpose, it is for them to demonstrate and not for the respondents to prove relying on M/s. Galaxy Theatre and others Vs. The State of Karnataka, .

20. In reply learned senior counsel Shri Datar sought to distinguish Video Electronics Pvt. Ltd. and Another and Weston Electronics Ltd. and Another Vs. State of Punjab and Another, as confined to the facts of that case. Reliance in this regard was placed on the observations in Shree Mahavir Oil Mills and Another Vs. State of Jammu & Kashmir and Others, . Shri Datar submitted that Video Electronics Pvt. Ltd. and Another and Weston Electronics Ltd. and Another Vs. State of Punjab and Another, was a case of complete tax exemption for a specified period. While granting exemption to special class for a limited period maintaining general rate of tax on all others in the State at par with those imported into the State was the distinguishing feature which must be appreciated. Special reference was made to paragraphs 34 and 35 to contend that it was decided on its own facts and could not be applied universally. Reliance was further placed on Weston Electroniks and Anr Vs. State of Gujarat and Ors, noticing H. Anraj Vs. Government of Tamil Nadu, that discrimination effect by

applying different rate of tax between goods imported and goods manufactured in the State must be struck down.

21. Lastly learned senior counsel Shri Datar submitted that the argument to justify the concession as having been granted for one year only was not sustainable in absence of any empirical data how grant of such concession for this extremely limited duration would achieve the desired industrial and social growth. If it had been a concession granted for ten years or five years to all iron and steel manufacturing units in the State the matter would have been different.

22. A consideration of the rival submissions necessitates to first notice section 15B of the VAT Act in its relevant extract which reads as follows:

"15B. Saving.--The State Government may, by notification and subject to such restrictions and conditions as may be specified therein, exempt whether prospectively or retrospectively,--

(i)(a) any class of dealers; or

(b) any goods or class of goods, in whole or in part, from the payment of tax under this Act for such period as may be specified in the notifications;"

23. Articles 301 and 304(a) in Part XIII of the Constitution read as follows:

301. Freedom of trade, commerce and intercourse.--Subject to the other provisions of this Part, trade, commerce and intercourse throughout the territory of India shall be free.

304. Restrictions on trade, commerce and intercourse among 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 are subject, so, however, as not to discriminate between goods so imported and goods so manufactured or produced;"

24. The Constitutional protection to freedom of inter-State trade and commerce throughout the territory of India in article 301 of the Constitution is but an embodiment of the guarantee in the Preamble of the Constitution for economic justice which in turn would promote social justice and equality of opportunity. Nonetheless, Parliament has power under article 302 to impose restrictions in public interest. Article 303 prohibits the Parliament or Legislature of the State to make any law giving preference to one State over another or discrimination between one State and another with regard to trade and commerce. The importance given to Part XIII of the Constitution is reflected in the Constitutional power of the Parliament to appoint an authority under article 307 for carrying out the purposes of the Chapter.

25. The provisions were first considered in Atiabari Tea Co., Ltd. Vs. The State of

Assam and Others, observing:

"51. ... Thus considered we think it would be reasonable and proper to hold that restrictions freedom from which is guaranteed by article 301 , would be such restrictions as directly and immediately restrict or impede the free-flow or movement of trade. Taxes may and do amount to restrictions; but it is only such taxes as directly and immediately restrict trade that would fall within the purview of article 301 . The argument that all taxes should be governed by article 301 whether or not their impact on trade is immediate or mediate, direct or remote, adopts, in our opinion, an extreme approach which cannot be upheld. If the said argument is accepted it would mean, for instance, that even a legislative enactment prescribing the minimum wages to industrial employees may fall under Part XIII because in an economic sense an additional wage bill may indirectly affect trade or commerce. We are, therefore, satisfied that in determining the limits of the width and amplitude of the freedom guaranteed by article 301 a rational and workable test to apply would be : Does the impugned restriction operate directly or immediately on trade or its movement?

...

52. ... Our conclusion, therefore, is that when article 301 provides that trade shall be free throughout the territory of India it means that the flow of trade shall run smooth and unhampered by any restriction either at the boundaries of the States or at any other points inside the States themselves. It is the free movement or the transport of goods from one part of the country to the other that is intended to be saved, and if any Act imposes any direct restrictions on the very movement of such goods it attracts the provisions of article 301 , and its validity can be sustained only if it satisfies the requirements of article 302 or article 304 of Part XIII ..."

26. The rate of tax under the VAT Act is five per cent for the two specified iron and steel products imported from outside the State while for manufacturers within the State falling in the two specified categories it is at a concessional rate of three per cent and four per cent, respectively. There has been no imposition of a higher rate of tax on similar goods imported from outside the State as compared to those manufactured inside the State so far as the two specified categories are concerned. But the inevitable result is that similar goods imported from outside the State become subject to a higher rate of tax. Will grant of such concession amount to an imposition by subjecting goods manufactured outside the State to a higher rate of tax? Does it then operate in effect as directly and immediately affecting trade and movement of the goods is the question for our consideration. Does it put manufacturers outside the State at a disadvantage by subjecting them to a higher rate of tax making their products uncompetitive in the State affecting the inflow of their goods into the State. Will it be permissible to do indirectly what is not permissible directly applying "the effect of the law test".

27. In Khandige Sham Bhat and Others Vs. The Agricultural Income Tax Officer, with regard to the effect of the law test it was observed as follows (page 26 in 48 ITR):

"... It will then be the duty of the court to scrutinise the effect of the law carefully to ascertain its real impact on the persons or property similarly situated. Conversely, a law may treat persons who appear to be similarly situate differently; but on investigation they may be found not to be similarly situate. To state it differently, it is not the phraseology of a statute that governs the situation but the effect of the law that is decisive. ..."

28. In Mrs. Maneka Gandhi Vs. Union of India (UOI) and Another, the inevitable consequence test was considered observing as follows:

"20.... If the test were merely of direct or indirect effect, it would be an open-ended concept and in the absence of operational criteria for judging ''directness'', it would give the court an unquantifiable discretion to decide whether in a given case a consequence or effect is direct or not. Some other concept-vehicle would be needed to quantify the extent of directness or indirectness in order to apply the test. And that is supplied by the criterion of ''inevitable'' consequence or effect adumbrated in the Express Newspapers (Private) Ltd. and Another Vs. The Union of India (UOI) and Others, . This criterion helps to quantify the extent of directness necessary to constitute infringement of a fundamental right. Now, if the effect of State action on fundamental right is direct and inevitable, then a fortiori it must be presumed to have been intended by the authority taking the action and hence this doctrine of direct and inevitable effect has been described by some jurists as the doctrine of intended and real effect..."

29. That taxing laws could also impede the Constitutional guarantee for freedom of inter-State trade was considered in Firm A.T.B. Mehtab Majid and Co. Vs. State of Madras and Another, observing as follows (page 360 in 14 STC):

"10. It is therefore now well-settled that taxing laws can be restrictions on trade, commerce and intercourse, if they hamper the flow of trade and if they are not what can be termed to be compensatory taxes or regulatory measures. Sales tax, of the kind under consideration here, cannot be said to be a measure regulating any trade or a compensatory tax levied for the use of trading facilities. Sales tax, which has the effect of discriminating between goods of one State and goods of another, may affect the free flow of trade and it will then offend against article 301 and will be valid only if it comes within the terms of article 304(a) .

11. Article 304(a) enables the Legislature of a State to make laws affecting trade, commerce and intercourse. It enables the imposition of taxes on goods from other States if similar goods in the State are subjected to similar taxes, so as not to discriminate between the goods manufactured or produced in that State and the goods which are imported from other States. This means that if the effect of the sales tax on tanned hides or skins imported from outside is that the latter becomes subject to a higher tax by the application of the proviso to sub-

rule (2) of rule 16 of the Rules, then the tax is discriminatory and unconstitutional and must be struck down."

30. In Weston Electroniks and Anr Vs. State of Gujarat and Ors, relied upon by the petitioners, electronic goods manufactured in Delhi were sold all over the country including Gujarat. Sales tax was levied by the State of Gujarat at the rate of 15 per cent in respect of manufacturers within the State or imported from outside. The State Government while reducing the tax on imported goods from 15 per cent to 10 per cent further reduced it for local manufacturers to one per cent. It was contended that by lowering the rate of tax in respect of goods manufactured within the State, the State Government has created an invidious discrimination adversely affecting the free-flow of inter-State trade and commerce contravening article 301 of the Constitution. Referring to Atiabari Tea Co., Ltd. Vs. The State of Assam and Others, , Firm A.T.B. Mehtab Majid and Co. Vs. State of Madras and Another, it was reiterated that restrictions hampering inter-State trade and commerce excluding compensatory or regulatory measures will fall foul of article 301 requiring compliance with article 304(a) . H. Anraj Vs. Government of Tamil Nadu, referred to by the petitioners with regard to higher rate of tax imposed on lottery tickets of other States while exempting lottery tickets issued by Government of Tamil Nadu was also noticed. It was held at paragraph 7 as follows (page 56 in 70 STC):

"7. In the result, the discrimination effected by applying different rates of tax between goods imported into the State of Gujarat and goods manufactured within that State must be struck down."

31. Video Electronics Pvt. Ltd. and Another and Weston Electronics Ltd. and Another Vs. State of Punjab and Another, has been relied upon by the respondents to justify the grant of concession to local manufacturers for limited duration while the petitioners have contended relying on Shree Mahavir Oil Mills and Another Vs. State of Jammu & Kashmir and Others, that it has to be read as confined to its own facts and not as a generalized proposition for the goal of industrial equality of States. By notification dated December 26, 1985, the State of Uttar Pradesh provided complete tax exemption to any goods manufactured in a new industrial unit fulfilling requirements for a specified period. It was challenged as violative of the freedom of inter-State trade and commerce under the Constitution by similar manufacturers outside the State. It was opined that economic development of a State for ensuring economic equality of States and thereby develop the economic unity of India was a vital goal to be achieved. Taxes which did not directly or immediately restrict or interfere with trade, commerce and intercourse would be excluded from ambit of article 301 . It was observed that imposition of sales tax, only had an indirect effect on trade and commerce. Considering the question whether power to grant exemption to specified class of manufacturers for limited period on certain conditions, the court relied upon the averment on behalf of the respondents urging the grounds and suggesting the need of incentives and exemptions of the nature granted as

absolutely necessary for economic viability and survival of these industries in the State. The grounds urged were found to be cogent and intelligible reasons of economic encouragement and growth. There was rationale in the ground urged clearly discernible holding that the exemption was based on natural and business factors not involving in intentional bias. Under these circumstances it was additionally noticed that the exemption was for a limited period. It was further noticed that general rate of tax to which outsiders were subjected was the same for those within the State not falling in the exempted category. In so far as the State of Punjab was concerned, the differential rate of sales tax for manufacturers outside the State, was declined interference noticing that except for the exempted category which were few in number, an overwhelmingly large number of local manufacturers of similar goods were also subject to sales tax at par with manufacturers from outside the State. Crucial is the discussion at paragraph 35 that naked blanket preference by grant of exemption to locally manufactured goods compared to those coming from outside the State without any reason or concession in favour of indigenous manufactured goods would be unsustainable relying, inter alia, on Weston Electroniks and Anr Vs. State of Gujarat and Ors, . It would be relevant to quote the following extract from the judgment (page 109 in 77 STC):

"36. ... A backward State or a disturbed State cannot with parity engage in competition with advanced or developed States. Even within a State, there are often backward areas which can be developed only if some special incentives are granted. If the incentives in the form of subsides or grant are given to any part or units of a State so that it may come out of its limping or infancy to compete as equals with others, that, in our opinion, does not and cannot contravene the spirit and the letter of Part XIII of the Constitution. However this is permissible only if there is a valid reason, that is to say, if there are justifiable and rational reasons for differentiation. If there is none, it will amount to hostile disaimination ..."

32. In Shree Mahavir Oil Mills and Another Vs. State of Jammu & Kashmir and Others, , due to higher production cost of edible oils in the State of J & K making it uncompetitive compared to edible oil imported from outside the State, to promote industrialization the State Government granted complete exemption from sales tax on locally manufactured edible oil for five years later extended to another five years for units with an investment of 10 lacs subsequently increased to 30 lacs. Manufacturers outside the State were required to pay tax at the rate of eight per cent. It was contended on their behalf that raising of this fiscal barrier violated the freedom of inter-State trade as it put them at a disadvantage making their products more expensive and uncompetitive. The Supreme Court held that States are free to levy taxes on goods imported from other States so long as they do not discriminate between goods imported and those manufactured in the State. The laudable object of the State to encourage and promote establishment and growth of industries could not be a justification to subject goods from outside the State to a discriminatory rate of tax. Referring to

Video Electronics Pvt. Ltd. and Another and Weston Electronics Ltd. and Another Vs. State of Punjab and Another, it was observed that the limited exception carved out therein cannot be enlarged to cover cases of different kinds as follows (page 161 in 104 STC):

"23....Suffice it to say that the limited exception carved out therein cannot be widened or expanded to cover cases of a different kind."

33. The effect of a concession in trade tax discriminating between goods imported from outside and those manufactured in the State and whether it contravenes articles 301 and 304(a) of the Constitution was considered in State of U.P. and Others Vs. Jaiprakash Associates Ltd., . The question related to grant of rebate to cement manufacturers inside the State of Uttar Pradesh using fly-ash while denying it to cement manufacturers outside the State but using fly-ash procured from inside the State of Uttar Pradesh. It was observed (paras 27, 38 and 40, pages 440, 445 and 446 in 65 VST):

"29. Article 304(a) of the Constitution is an exception to article 301 of the Constitution of India. Article 304(a) does not prevent levy of tax on goods; what is prohibited is such levy of tax on goods as would result in discrimination between goods imported from other States and similar goods manufactured or produced within the State. The object is to prevent imported goods being discriminated against by imposing a higher tax thereon than on local goods. What article 304(a) demands is that the rate of taxation on local as well as imported goods must be the same. This is designed to discourage the States from creating the State barriers or fiscal barriers at the boundaries.

30. Article 304(a) of the Constitution empowers the State to levy tax, with an intent that Part XIII of the Constitution does not affect the power of taxation given under Part XII of the Constitution. It is to preserve and protect the broad object of article 301 of the Constitution, article 304(a) only limits the power of the State Legislature from imposing such taxes that would discriminate between imported goods and domestic goods and restrict free movement of goods between States.

...

46. Article 304(a) is a provision that deals with taxation. It places goods imported from sister States on a par with similar goods manufactured or produced within the State in regard to State taxation in the allocated field. The object of article 304(a) was to limit the power of taxation by States so as to prevent discrimination against imported goods by imposing taxes on such goods as a higher rate than is borne by indigenous goods. The tax referred to in article 304(a) is a ''tax on goods''...

...

52. Exemption as we normally understand has twofold impact. First, exemptions/ concessional rate of tax affect consumer choice by impacting relative pricing and,

thus, materially altering the economic balance. It is because consumption will tend to shift towards untaxed items, the prices of those items and the items used to produce them will increase while the prices of taxed items will decrease relatively. Second, such exemptions unfairly burden some businesses either within the same industry or in other competing industries."

34. The State of Kerala Vs. A.B. Abdul Kadir and Others, relied upon by the respondents reiterates that it was only such restrictions or impediment which directly or immediately impede the free flow of trade, commerce and intercourse which would contravene article 301 of the Constitution and that every tax would not be automatically amount to doing so holding that every case had to be judged on its own facts and in its own setting of time and circumstances with regard to the effect of law.

35. Likewise in Vrajlal Manilal and Co. and Another Vs. State of M.P. and Another, relied upon by the respondents, it was held that an increase in the rate of tax on a particular commodity cannot per se be said to impede free trade and commerce. The conclusions were based on the fact that there was no material before the court that the higher rate of tax had caused the trade to decline.

36. Shree Digvijay Cement Co. Ltd. and Others Vs. State of Rajasthan and Others, related to reduction of sales tax on inter-State sale of cement by any dealer from the State of Rajasthan to four per cent thereby reducing the cost of cement manufactured in State of Rajasthan making it more competitive for sale in the neighbouring State to their disadvantage. It was held on facts that contrary to the challenge it had actually promoted inter-State trade resulting in increasing movement from State of Rajasthan to other States.

37. In the present case, a specific ground of challenge by the petitioners who are manufacturers outside the State, to the grant of concession in tax for local manufacturers, is that the respondents have not placed any cogent material or rationale on basis of a study carried out supported by empirical data how the grant of such concession in tax was necessary to encourage growth of these industries. How local manufacturers of the two products only falling in the two specified categories alone were sufficient and necessary to give the desired boost to industrialisation in the State. What was the number of such industries compared to others in the State. What impact the concession had on inflow of the two products from outside the State. Whether industrial units of the specified categories had closed down in absence of tax concessions. What had been the benefits of the concession from April 1, 2013. A very generalised statement has been made in the counter-affidavit not supported by any materials that it was necessary in a backward State.

38. It needs no emphasis that subjecting the same goods imported into the State to a higher rate of tax only as compared to those manufactured locally would make the imported goods more expensive making it unviable and uncompetitive. A natural corollary would be that inflow into the State of these goods from

outside the State would drop impeding inter-State trade and commerce. It needs no discussion that the manufacturers outside the State shall be put at a disadvantage and will find no takers for their products in the State who will naturally prefer to purchase it from those granted exemption in the State whose price and costs shall naturally be lesser and lower. No details have been furnished with regard to specified areas, or the number of unit falling in the exempted category situated in the State who have availed of the benefits since it was first introduced on March 30, 2013 and how it has contributed to the economic growth of the State. The respondents have not furnished any data for distinguishing one per cent tax between the two exempted categories of small and medium scale enterprises and an investment limit of 10 lacs. No material has been brought on record that despite grant of exemption manufacturers outside the State have not been put at disadvantage and are continuing to do business. Likewise there is no data with regard to number of industrial units falling outside the exempted category in the State and whether they had been affected or not by the grant of concession. How the exempted category alone had given the desired impetus to industrialisation and how it was necessary to do so and the manner in which it would give a economic boost to the State.

39. We are therefore constrained to hold that the impugned notification to the extent that it puts at a disadvantage manufacturers outside the State from doing business in the State putting them at a competitive disadvantage, contravenes articles 301 and 304(a) of the Constitution. The effect of granting exemption to the specified category of manufacturers only is to raise the rate of tax for manufacturers from outside the State. It is not necessary that this discrimination must be only by a positive act of imposition and it can well be by a negative effect of exemption. The effect of such exemption is to subject the local exempted category to a different rate of tax from those outside the State. It shall be the test of the effect of the exemption which shall be crucial to decide if it impedes free-flow of inter-State trade and commerce.

40. The second ground of challenge to the notification for exemption is by manufacturers of steel bars (excluding in coil form) and steel structural within the State who do not fall in the category of small and medium scale industrial unit and have investment beyond ten crores. Those manufacturing the two specified products in the State form a class. Article 14 of the Constitution permits classification but prohibits class legislation. In Prabodh Verma and Others Vs. State of Uttar Pradesh and Others, it was observed:

"40. ... Article 14 , however, does not forbid classification. The principle underlying the guarantee of article 14 is not that the same rules of law should be applicable to all persons within the territory of India irrespective of differences of circumstances. It only means that all persons similarly circumstanced should be treated alike and there should be no discrimination between one person and another if as regards the subject-matter of the legislation, their position is substantially the same. By the process of classification, the State has the power to determine who should be regarded as a class for the purposes of legislation and in relation to a law enacted on a particular subject. The classification to be valid, however, must not be arbitrary but must be rational. It must not only be based on some qualities or characteristics which are to be found in all the persons grouped together and not in others who are left out but those qualities or characteristics must have a reasonable nexus or relation to the object of the legislation. In order to pass the test, two conditions have to be fulfilled, namely, (1) that the classification must be founded on an intelligible differentia which distinguishes those that are grouped together from others, and (2) the differentia must have a rational nexus or relation to the object sought to be achieved by the legislation."

41. There is no intelligible differentia discernible in creation of these two categories of manufacturers and purchasers from them as a separate favoured class having any nexus with any object of quick industrialisation to be achieved by rationale. No empirical data has been placed with regard to the number of units in each of the two exempted categories, or how many of them had closed down and dealerships surrendered in absence of concessions in recent preceding years. The number of industrial units falling outside the exempted categories and that grant of concessions had not affected them in any manner and none had closed down. Levying of a higher rate of tax on other local manufacturers may well sound the death knell for them in the State rendering them unproductive and uncompetitive. Section 15B of the VAT Act has rightly been urged to be applicable to a class of dealers. If all manufacturers of the two products form a class of dealers and there is no rationale for differentiating criteria between them, it violates the constitutional guarantee for equality under article 14 and the notification is liable to be struck down on that ground also. In State of Andhra Pradesh and Others Vs. Nallamilli Rami Reddi and Others, , it was observed:

"8. What article 14 of the Constitution prohibits is ''class legislation'' and not ''classification for purpose of legislation''. If the Legislature reasonably classifies persons for legislative purposes so as to bring them under a well-defined class, it is not open to challenge on the ground of denial of equal treatment that the law does not apply to other persons. The test of permissible classification is two fold : (i) that the classification must be founded on intelligible differentia which distinguishes persons grouped together from others who are left out of the group, and (ii) that differentia must have a rational connection to the object sought to be achieved. Article 14 does not insist upon classification, which is scientifically perfect or logically complete. A classification would be justified unless it is patently arbitrary. If there is equality and uniformity in each group, the law will not become discriminatory, though due to some fortuitous circumstance arising out of peculiar situation some included in a class get an advantage over others so long as they are not singled out for special treatment. In substance, the differentia required is that it must be real and substantial, bearing some just and reasonable relation to the object of the legislation."

42. The notification dated May 30, 2014 is held to be bad on both counts of contravening articles 301 and 304(a) of the Constitution as also violating the equality clause under article 14 of the Constitution. The notification is therefore struck down. The writ petitions are allowed.

