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STATE OF KERALA

v.

SOUTH INDIA CORPORATION(P) LTD.

March 29, 1971

B [S. M. SIKRI, C. J., G. K. MITTER, K. S. HEGDE, A. N. GROVER AND P. JAGANMOHAN REDDY, JJ.]

Constitution of India, 1950, Arts. 277 and 278—Repeal and re-enactment of tax laws: if affects continuity of levy—Agreement under Art. 278 by which State agrees with Union not to impose tax—If breaks continuity of levy.

C The State of Travancore and Cochin, before 26th January 1950, had plenary powers of legislation and under the Travancore General Sales Tax Act, 1948, and the Cochin General Sales Tax Act, 1945, as amended in 1948, they levied sales-tax on works contracts. As a result of the merger of the two states into a Part B State under the Constitution, the Travancore-Cochin General Sales Tax Act, 1950, was enacted, and, after the State of Kerala came into existence in 1956, the Act was called the Kerala General Sales Tax Act, and its operation was extended the whole of the State. D That Act enabled the imposition of sales tax on works contracts, but, on February, 25, 1950, an agreement was entered into between the Raj Pramukh and the Union of India, under Art. 278 of the Constitution, under which, the State had no power to impose sales-tax in respect of works contracts. That agreement, was to enure for ten years.

E For the period 26th January 1960 to 31st March, 1960, the State levied sales tax on works contracts. On the question whether the levy was saved by Art. 277 of the Constitution.

F HELD: Under Art. 277, any taxes which, immediately before the commencement of the Constitution, were being lawfully levied by a State, may, notwithstanding that the taxes are mentioned in the Union list in the Constitution continue to be levied by the State until provision to the contrary is made by Parliament. The impost of sales-tax on works contracts is, under the Constitution, beyond the competence of the States but would be within that of Parliament by virtue of item 97, List I, VII Schedule and Art. 248 of the Constitution. Therefore, sales-tax on works contracts which were being lawfully levied by the States of Travancore and Cochin before 26th January 1950, could under Art. 277, be continued to be levied. The fact that former Acts were repealed and re-enacted would not take the case out of Art. 277, because, all that the Article requires is a *continuity in the levy* of taxes without any change in their character. But this essential condition of continuity in the levy for the validity of the imposition of the tax was broken in the present case, by the agreement under Art. 278. Articles 277 and 278 were engrafted in the Constitution with the object of maintaining financial stability of the new States. The agreement shows that there was liberal financial assistance to make up for the loss of revenue which the State was deriving from the sales-tax on works contracts. Since the agreement broke the continuity of the levy of sales-tax on works contracts, and there was nothing in Art. 277 to resuscitate it when the agreement came to an end in 1960, no sales-tax on works contracts was leviable by the State after 26th January 1960. [240A-B, E-A ; 241A ; 243A-F]

South India Corporation (P) Ltd. v. Secretary Board of Revenue, Trivandrum, [1964] 4 S.C.R. 280, referred to.

Civil Appellate Jurisdiction : Civil Appeals Nos. 175 to 178 A
of 1969.

Appeals from the judgements and orders dated February 6, 1968 and September 5, 1967 of the Kerala High Court Writ Appeal No. 243 of 1967, T.R.C. Nos. 22 and 23 of 1966 and Original Petition No. 1046 of 1966. B

M. C. Chaghla and *A. G. Puddissery*, for the appellants (in all the appeals.)

S. T. Desai *A. S. Nambiar* and *K. R. Nambiar*, for the respondent (in all the appeals). C

The Judgment of the Court was delivered by

Mitter, J.—All these four appeals are by certificate granted by the High Court of Kerala. Three of them arise out of a common judgement in T.R.C. Nos. 22 and 23 of 1966 and Original Petition No. 1046 of 1966. Appeal No. 175 of 1969 is from the judgment in Writ Appeal No. 243 of 1967 arising out of original Petition No. 1723 of 1965. D

The respondent, a private limited company having its principal place of business at Mattancherry originally in the State of Cochin but now in the State of Kerala, was assessed by the State tax Officer, Special Circle, Mattancherry, to sales-tax for the years 1960-61 and 1961-62 on turnovers which included "works contracts" executed by the respondent. Before the taxing authorities the contention raised by the respondent was that the turnover on these contracts could not be subject to sales tax. Tax Revision Cases 22 and 23 of 1966 were filed in the High Court under s. 41 of the Kerala General Sales Tax Act, 1963 to revise the decision of the Tribunal. These were heard by the High Court along with the Original Petition No. 1046 of 1966. Civil Appeal No. 175 of 1969 relates to the assessment for the year 1959-60 by which a turnover of Rs. 6,09,954.98 relating to works contracts was included. The Tribunal upheld the levy of sales tax on works contracts relating to the period 26th January 1960 to March 31, 1960 and remanded the case. The respondent thereupon filed O. P. No. 1723 of 1965. A single Judge of the High Court quashed the impugned order and this was confirmed in Writ Appeal No. 243 of 1967. The State, the Kerala Sales-tax Appellate Tribunal and the Inspecting Assistant Commissioner of Agricultural Income-tax and Sales-tax, Ernakulam have come up in appeals to this Court and the common respondent is the company. E

- A The Central question in all these appeals is, whether the provisions of the General Sales Tax Act XI of 1125 (corresponding to Christian era 1950) imposing a tax on works contracts were enforceable in the State of Kerala subsequent to January 26, 1960. The history behind the present law of sales tax on this point in the State of Kerala is as follows. The territory of the said State is composed *inter alia* of major parts of the erstwhile States of Travancore and Cochin which were separate sovereign States having plenary powers of taxation. Under the Sales Tax Act of both these States tax was exigible on works contracts. The Cochin Act was known as the Cochin General Sales Tax Act XV of 1121 (Christian era 1945) as amended by Act V of 1124 (Christian era 1948 AD). The Travancore Act was known as the Travancore General Sales Tax Act XVIII of 1124 (corresponding to 1948). As a result of the merger of the two States, the State of Travancore-Cochin with a common legislature emerged as a part B State under the Constitution of India as originally in force. The said legislature enacted the Travancore Cochin General Sales Tax Act XI of 1125 (corresponding to 1949 A.D.) imposing sales tax on works contracts. The Act was published in the local gazette on January, 17, 1950 but under the provisions of s. 1(3) thereof it came into force on May 30, 1950 i.e., after the date of the promulgation of the Constitution. The last mentioned Act repealed the acts of the Travancore and Cochin States but enacted identical provisions of taxation regarding works contracts.
- E The State of Kerala came into existence as a result of the States Re-organisation Act as from 1st November 1956. The Kerala Legislature passed the Travancore Cochin General Sales Tax Amendment Act, 1957 amending the name of the Travancore Cochin Act XI of 1125 and extending its operation to the whole of the State of Kerala. This Act came into force on October 1, 1957. The said Legislature also passed the Kerala Surcharge on Taxes Act, 1957 (12 of 1957) for levy surcharge on various taxes including those on sales or purchase of goods etc. This came into force on 1st September, 1957. The General Sales Tax Act (XI of 1125) was replaced by the Kerala General Sales Tax Act (XV of 1963) which came into force on April 1, 1963. There was no provision in this Act for imposition of tax on works contracts.
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- H Even before the litigations giving rise to the present set of appeals, the respondent had challenged the imposition of sales tax on works contracts for the assessment years 1952-53 as also for the years 1956-57 and 1957-58 before the High Court of Kerala under Art. 226 and Art. 227 of the Constitution. The High Court's decision in favour of the taxing authorities was upset in appeal to this Court in the year 1964, in *South India Corporation*

(P) Ltd. v. Secretary Board of Revenue, Trivandrum⁽¹⁾). Although the appellant in that case raised various contentions before this Court to negative its liability to sales tax on works contracts, this Court held that during the period covered by the agreement (which was to enure for ten years) dated February 25, 1950 entered into between the Raj Pramukh of Travancore and the Union of India under Art. 278 of the Constitution the State had no power to impose sales tax in respect of works contracts but the Court expressed no opinion as to whether such tax would be leviable after the expiry of the period of the agreement as this point was not involved in the appeal.

In the instant cases the points urged on behalf of the assessee before the High Court were:

- (i) That the levy of the tax on works contracts under the provisions of the General Sales Tax Act XI of 1125 for the period 26th January 1960 to 30th March 1963 is not saved by Art. 277 of the Constitution; and
- (ii) the levy is violative of Art. 14 of the Constitution.

Two learned Judges of the High Court Bench constituted to hear the first three matters came to the conclusion that the right to levy tax did not survive after the period covered by the agreement dated 25th February, 1950. The third learned Judge took a different view. But all the three Judges were agreed that the levy if otherwise justified was not violative of Art. 14 of the Constitution.

There can be no doubt—and indeed there was no suggestion—that after the Constitution came into force it was not open to the States to levy sales tax on works contracts under any Entry in List II of the Seventh Schedule to the Constitution. In *The State of Madras v. Ganon Dunkerley & Co. (Madras) Ltd.*⁽²⁾ it was held that Entry 48 in List II in Schedule VIII of the Government of India Act, 1935 did not extend to imposing a tax on the value of materials used in construction works, and that the provision introduced into the Madras General Sales Tax Act 1939 by the Amending Act of 1947 authorising the imposition of such tax was *ultra vires*. Any such imposition under Entry 54 of List II of the Seventh Schedule to the Constitution would meet the same fate. At the same time it must be noted that in *Mithan Lal v. The State of Delhi and another*⁽³⁾ this Court held that Parliament was competent to impose a tax on the supply of materials in building contracts and to impose it under the name of sales tax, as was done by Part C States (Laws) Act, 1950 by virtue of which the

(1) [1964] 4 S. C. R. 280

(2) [1959] S. C. R. 379

(3) [1959 S. C. R. 445]

- A Chief Commissioner of Delhi issued a notification extending the operation of the Bengal Finance (Sales Tax) Act, 1941 to Delhi. However, as the States of Travancore and Cochin had plenary powers of legislation they could levy tax on works contracts describing the same as sales tax. The levy of such taxes after the 26th January 1950 would depend on the construction of the relevant provisions of the Constitution as applicable to the said territories. Apart from the provisions of Arts 277 and 278 (which now stands repealed by the Constitution (Seventh Amendment) Act, 1956) their validity would have to be determined under Art. 372 of the Constitution. This Court has held in a number of cases that "a pre-Constitution law made by a competent authority, though it has lost its legislative competency under the Constitution, shall continue in force, provided the law does not contravene the 'other provisions' of the Constitution". It would be enough to refer to the above dictum based on a catena of decisions mentioned in the *South India Corporation (P) Ltd.* case (*supra*) at pp. 294-295.

D Art. 372 is a general provision meant to secure the continuance of existing laws in force in the territory of India on the advent of the Constitution. Art. 277 however engrafted a special provision for saving the impost of certain taxes, duties, cesses etc. which were being lawfully levied therefore in the following terms:—

- E "Any taxes, duties, cesses or fees which, immediately before the commencement of this Constitution, were being lawfully levied by the Government of any State or by any municipality or other local authority or body for the purposes of the State, municipality, district or other local area may, notwithstanding that those taxes, duties, cesses or fees are mentioned in the Union List, continue to be levied and to be applied to the same purposes until provision to the contrary is made by Parliament by law."

- G The impost of sales tax on works contracts though beyond the competence of the States would be within that of Parliament by virtue of item 97 of List I of Seventh Schedule and Art. 248 of the Constitution. It would therefore follow that if there was no other law touching this point, sales taxes on works contracts which were being lawfully levied by the Governments of the States of Travancore and Cochin before 26th January 1950 would continue to be levied and to be applied to the same purposes until provision to the contrary was made by Parliament by law. The fact that the Sales Tax Acts of the former States of Travancore and Cochin were repealed but identical provisions were re-enacted in the later Acts would not take the case out of Art. 277. All

that the said article requires is that there should be a continuity in the levy of taxes and so long as the character of the taxes did not change they would be saved by the said article.

We have however also to take note of Art. 278 which has now disappeared from the Constitution but held the field in 1950 when an agreement was entered into in terms thereof by and between the President of India and the Raj Pramukh of Travancore. Art. 278 run as follows:—

“(1) Notwithstanding anything in this Constitution, the Government of India may, subject to the provisions of clause (2), enter into an agreement with the Government of a State specified in Part B of the First Schedule with respect to—

(a) the levy and collection of any tax or duty leviable by the Government of India in such State and for the distribution of the proceeds thereof otherwise than in accordance with the provisions of this Chapter;

(b) the grant of any financial assistance by the Government of India to such State in consequence of the loss of any revenue which that State used to derive from any tax or duty leviable under this Constitution by the Government of India or from any other sources;

(c) the contribution by such State in respect of any payment made by the Government of India under clause (1) of Article 291 and when an agreement is so entered into, the provisions of this Chapter shall in relation to such State have effect subject to the terms of such agreement.

(2) An agreement entered into under clause (1) shall continue in force for a period not exceeding ten years from the commencement of this Constitution :

Provided that the President may at any time after the expiration of five years from such commencement terminate or modify any such agreement if after consideration of the report of the Finance Commission he thinks it necessary to do so.”

The decision of this Court in *The South India Corporation (P) Ltd.* (supra) elucidates the purpose of Art. 278 and the object with which the President of India entered into the agreement with the Raj Pramukh of Travancore. For our present purpose it will

A suffice to quote a portion of the said judgement. According to that judgment the agreement :

"Incorporated the recommendations made by the Indian States Finances Enquiry Committee with some modifications and the Union of India agreed to recoup the State for the loss caused to it by reason of the federal financial integration in the manner described thereunder. It was not a piecemeal agreement confined to a few items, but a comprehensive one to fill up the entire revenue-gap caused to the State by reason of some of its sources of revenue having been taken away by the Union or otherwise lost to it."

C Further (see p. 292) :

"The agreement, read with the Report, makes the following position clear : The loss arising to the State on account of the federal financial integration in the State was ascertained and a provision was made for subsidising the State by filling up the said revenue-gap. The agreement *ex facie* appears to be a comprehensive one. It takes into consideration the entire loss caused to the State by reason of some of its sources of revenue being transferred under the Constitution to the Union. It would be unreasonable to construe the agreement as to exclude from its operation certain taxes which the State was authorised to levy for a temporary period.....that saving was subject to an agreement and, as by the agreement effective adjustments were made to meet the loss which the State would have incurred but for the agreement, there was no longer any necessity for the continuance of the saving and it ceased to have any force thereafter between the parties to the agreement."

The Court also opined that it was not called upon to decide whether the said power revived after the expiry of ten years from the commencement of the Constitution, for all the impugned assessments fell within the said period. The Court observed that there was no force in the contention that because Art. 278 was omitted by the Constitution (Seventh Amendment) Act, 1956, the agreement entered into in exercise of a power thereunder automatically came to an end and thereafter the power of the State to levy the tax would come into life again.

H It was enough for the Court in that case to say that the agreement would have its full force unless the Constitution (Seventh Amendment) Act, 1956 in terms avoided it and in the result it held that the impugned assessment orders were not validly made

by the sales tax authorities in exercise of the power saved by Art. 277 of the Constitution. A

The question directly arises before us as to whether Art. 277 would still have effect in regard to the power to levy taxes falling within its scope after the said agreement of 25th February 1950 came to an end. The answer must clearly be in the negative because the essential condition for the validity of the imposition is the continuity of the levy and once there is a break in its operation it ceases to be effective and it cannot matter that no provision to the contrary as envisaged by Art. 277 was made by Parliament. B

It is clear that Art. 277 and particularly Art. 278 were engrafted in the Constitution with the immediate object of maintaining the financial viability of the new States for such time as the Parliament thought proper. So far as the State of Kerala was concerned the need for financial assistance was met by the agreement between the President of India and the Raj Pramukh of Travancore. That agreement itself shows that there was liberal assistance for the first five years which was to be tapered off in another five years' time. It would not be wrong to observe that it was contemplated that after ten years the State of Kerala would be able to find its own feet and do without any special assistance from the Centre. One of the objects of the said agreement was to recoup the State of Kerala for the loss of revenue which that State used to derive from *inter alia*, the sales tax on works contracts being a tax which was leviable under the Constitution by the Government of India alone. The agreement came to an end in 1960 and with it the financial assistance rendered in terms thereof. The agreement broke the continuity of the levy of sales tax on works contracts and there is nothing in Art. 277 to resuscitate it. C
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In the result we must hold that sales tax on works contracts was not leviable by the State of Kerala after the 26th January 1960 under the Kerala General Sales Tax Act XI of 1125. The appeals therefore fail and are dismissed with costs. There will be one set of hearing fee. F

V.P.S.

Appeals dismissed.