

3. Article 304 Interstate Trade & Commerce – Polity

Taxation cannot be weaponised to discriminate against goods imported from other states – Supreme Court. The Supreme Court struck down a Rajasthan VAT notification for violating Article 304(a) of the Constitution. The ruling affirmed that states cannot use taxation to discriminate against goods from other states, thereby protecting the principle of a single, unified Indian market.

Supreme Court Strikes Down Discriminatory VAT Exemption

The Supreme Court of India invalidated a 2007 notification from the Rajasthan government. This notification had exempted Value Added Tax (VAT) on asbestos cement sheets and bricks that were manufactured within Rajasthan, while levying the tax on identical goods imported from other states. The Court found this practice to be discriminatory and a violation of Article 304(a) of the Indian Constitution.

Relevant Constitutional Provisions

Article 301 – Freedom of Trade and Commerce – This article guarantees the freedom of trade, commerce, and intercourse throughout the territory of India. Its primary goal is to ensure economic unity and break down state-level barriers, fostering a single, integrated national market.

Article 304 – State's Power to Regulate Trade – This article acts as an exception to Article 301, granting states limited power to regulate trade and commerce.

Article 304(a) – It allows a state to impose a tax on goods imported from other states or Union Territories. However, this is subject to a critical condition – similar goods manufactured within the state must be subjected to an equivalent tax. This clause is designed to prevent protectionist tax policies that favor local industries over those from other states.

Article 304(b) – A state can impose "reasonable restrictions" on the freedom of trade and commerce in the public interest. However, any bill or amendment for this purpose requires the prior sanction of the President.

Supreme Court's Key Observations

The Court provided a detailed analysis, clarifying the line between permissible tax differentiation and unconstitutional discrimination.

Taxation Cannot be Weaponised – The Court firmly stated that states cannot use their taxation powers as a tool to create a protectionist environment that gives an unfair advantage to local manufacturers over those from outside the state.

Distinction between Differentiation and Discrimination –

Permissible Differentiation – A tax law is valid if it imposes an equal burden on both locally produced goods and imported goods. States can differentiate between goods for taxation purposes based on valid criteria.

Unconstitutional Discrimination – Discrimination occurs when the tax burden is heavier on goods coming from outside the state compared to similar local goods, creating a direct impediment to the free flow of trade.

Legitimate Exceptions – The Court acknowledged that not all tax incentives are discriminatory. States can provide tax reliefs or exemptions to encourage industrial development in economically backward areas, provided these measures are for a limited duration and are not designed to be hostile to goods from other states.

Analysis of the Rajasthan Notification – The Court found Rajasthan's notification to be discriminatory because the VAT exemption was exclusively for goods manufactured *within* the state that used at least 25% fly ash. Crucially, the notification did not extend this exemption to goods manufactured *outside* Rajasthan, even if they met the same criterion of using 25% fly ash. The Court pointed out that the exemption would have been non-discriminatory if it had been based on the *source of the raw material* (e.g., applicable to all goods using fly ash sourced from Rajasthan), irrespective of where the final product was manufactured.

Clarification on Judicial Precedent

Video Electronics Pvt. Ltd. v. State of Punjab (1990) – In this earlier case, the Supreme Court had upheld

certain sales tax exemptions, ruling that tax laws are not invalid simply because they have an indirect or incidental impact on trade and commerce.

Distinction in the Present Case – The Court clarified that the Rajasthan notification did not fall under the protective umbrella of the *Video Electronics* judgment. The exemption created a direct and significant price advantage for local goods, thereby directly impeding the free movement of similar goods from other states, which goes beyond an "indirect impact."

Significance of the Ruling

This judgment has far-reaching implications for India's economic and federal structure.

Strengthening Economic Integration – By striking down a protectionist tax measure, the ruling reinforces the constitutional mandate for a unified Indian market and prevents economic fragmentation caused by states creating trade barriers.

Providing Constitutional Clarity – The judgment offers a clear and precise interpretation of the scope and limits of Articles 301 and 304. It serves as a guiding principle for states on how to frame their tax policies without violating the freedom of interstate trade.

Advancing the 'One Nation, One Market' Goal – The ruling aligns perfectly with the underlying philosophy of the Goods and Services Tax (GST) framework, which aims to create a seamless national market by eliminating cascading taxes and regional barriers.

Ensuring Balanced Federalism – The decision strikes a crucial balance. While it protects the fiscal autonomy of states to levy taxes, it subjects this power to the constitutional check against discrimination, ensuring that federal principles do not undermine national economic unity.

Source – <https://indianexpress.com/article/legal-news/taxation-cannot-be-weaponised-to-discriminate-against-goods-imported-from-other-states-supreme-court-10270649/>

