IN THE HIGH COURT OF JUDICATURE AT BOMBAY

CIVIL APPELLATE JURISDICTION

WRIT PETITION NO.33 OF 2012

M/s.Mahalaxmi Cotton Ginning Pressing
and Oil Industries, Kolhapur. ...Petitioner.

Vs.

The State of Maharashtra & Ors. ...Respondents.

....

Mr.V.Sridharan, Senior Advocate with Mr.V.P. Patkar, Mr.C.B.Thakar, Mr.Ratan Kumar Samal, Mr.Jitu D.Patel and Mr.M.M.Vaidya for the Petitioner.

Mr.D.J.Khambata, Advocate General with Mr.E.P.Bharucha, Senior Advocate, Mr.D.A. Nalavade, Government Pleader, Mr.Vinay A.Sonpal, A Panel Counsel, Mr.B.B.Sharma, AGP, Ms.Naira Jejeebhoy and Ms.S.E.Bharucha for the Respondents.

.....

CORAM : DR.D.Y.CHANDRACHUD AND R.D.DHANUKA, JJ.

May 11, 2012.

JUDGMENT (PER DR.D.Y.CHANDRACHUD, J.) :

Rule, made returnable forthwith. With the consent of learned Counsel and at their request the Petition is taken up for hearing and final disposal.

2. The constitutional validity of Section 48(5) of the Maharashtra Value Added Tax Act, 2002 (MVAT Act, 2002) is in

challenge. In the alternative, if its validity is upheld, the Petitioner seeks that the words "actually paid" be read down to mean "ought to have been paid". The Petitioner challenges an order of assessment and seeks a mandamus to the State to recover from the vendor tax paid on goods of which a set off is claimed. Consequential orders of set off and refund are sought.

Facts

3. The Petitioner which is a partnership firm and a dealer registered under the MVAT Act, 2002, carries on business as a reseller in cotton bales. For 2009-10, the Petitioner filed its returns and, based on the purchases effected by it, claimed Input Tax Credit (ITC) by way of a set off under Section 48. According to the Petitioner, the claim was supported by tax invoices of its vendor. On 4 December 2010, the Petitioner claimed a refund of Rs.21.08 lakhs, resulting from the return filed. The Petitioner claims to have submitted data, transactionwise, in relation to its supplier, including the invoice number, date of supply, the registration number of the supplier and VAT paid on each purchase. By a letter dated 25 July 2011, the Deputy Commissioner of Sales Tax,

Kolhapur informed the Petitioner of a list of dealers from whom the Petitioner had effected purchases where the data received was matched or, as the case may be, unmatched. The Petitioner was called upon to submit ledger copies and proof of the filing of returns by the dealer in those cases where the data was unmatched. Failing this, it was stated that ITC of the concerned dealers would be disallowed. After a personal hearing the Deputy Commissioner by his letter dated 16 September 2011 communicated the quantum of ITC which was allowable in accordance with a 'matched list' and that which was not allowable according to an 'unmatched list'. The Petitioner was also informed that the assessment would be taken up under Section 23. The Deputy Commissioner of Sales Tax passed an order of assessment on 20 October 2011. The Assessing Officer allowed a set off to the Petitioner to the extent of Rs.48.95 lakhs and reduced the claim of refund from Rs.21.08 lakhs to Rs.2.17 lakhs.

MVAT Act

4. The MVAT Act, 2002 was brought into force with effect from 1 April 2005. The Act replaced a single point levy under the erstwhile Bombay Sales Tax Act, 1959 with a multi point levy.

The Act was legislated upon by the State Legislature in pursuance of a decision taken by the Empowered Committee of Finance Ministers of the States to bring in a value added tax system. The White Paper circulated by the Empowered Committee of State Finance Ministers on 17 January 2005 furnished the following rationale for the introduction of VAT:

> "In the existing sales tax structure, there are problems of double taxation of commodities and multiplicity of taxes, resulting in a cascading tax burden. For instance, in the existing structure, before a commodity is produced, inputs are first taxed, and then after the commodity is produced with input tax load, output is taxed again. This causes an unfair double taxation with cascading effects. In the VAT, a set off is given for input tax as well as tax paid on previous purchases. In the prevailing sales tax structure, there is in several States also a multiplicity of taxes, such as turnover tax, surcharge on sales tax, additional surcharge, etc. With introduction of VAT, these other taxes will be abolished. In addition, Central sales tax is also going to be phased out. As a result, overall tax burden will be rationalised, and prices in general will also fall. Moreover, VAT will replace the existing system of inspection by a system of built-in self-assessment by the dealers and auditing. The tax structure will become simple and more transparent. That will improve tax compliance and also augment revenue growth. Thus, to repeat, with the introduction of VAT, benefits will be as follows :
>
> - a set-off will be given for input tax as well as tax paid on previous purchases

- other taxes, such as turnover tax, surcharge, additional surcharge, etc. will be abolished
- overall tax burden will be rationalised
- prices will in general fall
- there will be self-assessment by dealers
- transparency will increase
- there will be higher revenue growth"

5. Section 3 of the MVAT Act, 2002, provides for the incidence of the tax. Sub-section (1) prescribes that every dealer, who before the appointed day holds a valid or effective certificate of registration or licence under any of the earlier laws or, is liable to pay sales tax thereunder whose turnover of sales or purchases has exceeded rupees five lakh or who was an importer whose turnover had exceeded rupees one lakh with effect from the appointed day, would be liable to pay tax. Under sub-section (2) of Section 3, a dealer to whom sub-section (1) does not apply and whose turnover of all sales made, during the year commencing on the appointed day or any subsequent year exceeds the limit specified in sub-section (4) is liable to pay tax under the Act with effect from the first day of April of the respective year. Under

Section 4, it has been specified that subject to the provisions of the Act and rules, there shall be paid by every dealer or, as the case may be, every person, who is liable to pay tax under the Act, the tax or taxes leviable in accordance with the Act and rules. Under Section 6 tax is levied on the turnover of sales of goods specified in Schedules B, C, D or E at the rates set out therein. The expression "sale price" is defined in Section 2(25) as follows:

> "(25) "sale price" means the amount of valuable consideration paid or payable to a dealer for any sale made including any sum charged for anything done by the seller in respect of the goods at the time of or before delivery thereof, other than the cost of insurance for transit or of installation, when such cost is separately charged."

Explanation II inter alia stipulates that the sale price shall not include tax paid or payable to a seller in respect of such sale. Section 16 contains a prohibition to the effect that a dealer while being liable to pay tax under the Act, shall not be engaged in the business as a dealer, unless he possesses a valid certificate of registration. Moreover, a person or dealer who is registered is liable to pay tax during the period in which the registration certificate is effective, notwithstanding the fact that subsequently it

is found that no registration certificate was necessary in his case. Section 60 of the MVAT Act, 2002, stipulates that no person shall collect any sum by way of tax in respect of sales of any goods which are not taxable goods. Moreover, a person who is not a registered dealer is prohibited from collecting, in respect of any sales of goods, any sum by way of tax from any other person. A registered dealer is prohibited from collecting any amount by way of tax in excess of the tax payable by him on any sale of goods under the provisions of the Act.

6. Under the Scheme of the Act, every dealer is liable to pay tax on a sale transaction with a purchasing dealer. The dealer is also entitled to claim by way of a set off under Section 48 the tax paid on his purchases as ITC. Section 86 prescribes a tax invoice which is issued, by a selling dealer, indicating the amount of tax recovered. The tax invoice has to contain a certification that the registration of the selling dealer under the MVAT Act, 2002 is in force on the date on which the sale of the goods specified in the tax invoice took place; that the transaction of sale has been effected by the selling dealer and shall be accounted for in the turnover of sales

while filing the return and that the due tax, if any, payable on the sale has been paid or shall be paid.

7. The controversy in the case turns upon Section 48. Section 48 provides as follows :

> "48. Set-off, refund, etc.
> (1) The State Government may, by rules, provide that, -
> (a) in such circumstances and subject to such conditions and restrictions as may be specified in the rules, a set-off or refund of the whole or any part of the tax,-
>
> (i) paid under any earlier law in respect of any earlier sales or purchases of goods treated as capital assets on the day immediately preceding the appointed day or of goods which are held in stock on the appointed day by a person who is a dealer liable to pay tax under this Act, be granted to such dealer; or
>
> (ii) paid in respect of any earlier sale or purchase of goods under this Act be granted to the purchaing dealer; or
>
> (iii) paid under the Maharashtra Tax on Entry of Motor Vehicles into the Local Areas Act, 1987, (Mah. XLII of 1987) be granted to the dealer purchasing or importing motor veicles; or
>
> (iv) paid under the Maharashtra Tax on Entry of Goods into the Local Areas Act, 2002, (Mah. - of 2002) be granted to the dealer;
>
> (b) for the purpose of the levy of tax under any of the

provisions of this Act, the sale price may in the case of any class of sales be reduced to such extent, and in such manner, as may be specified in the rules.

(2) No set-off or refund as provided by any rules made under this Act shall be granted to any dealer in respect of any purchase made from a registered dealer after the appointed day, unless the claimant dealer produces a tax invoice, containing a certificate that the registration certificate of the selling dealer was in force on the date of sale by him and the due tax, if any, payable on the sale has been paid or shall be paid and unless such certificate is signed by the selling dealer or a person duly authorised by him.

(3) Subject to the provisions contained in sub-section (4), where no tax has been charged separately under any earlier law, the rate of tax applicable for the purposes of calculating the amounts of set-off, or refund in respect of any earlier sale or purchase of goods, or for the purposes of reduction of sale or purchase price for levy of tax, shall be the rate set-out against the goods in the relevant Schedule under any earlier law.

(4) Where, under any notification issued under this Act or as the case may be, any earlier law, any sale or purchase of goods has been exempted from the payment of whole of sales tax or purchase tax, then, for the purposes of sub-section (3), the rate of tax applicable shall be nil; and where it is exempted from payment of any part of sales tax (or purchase tax), the rate of tax applicable shall be the rate at which the payment of tax is to be made by cirtue of such exemption.

(5) For the removal of doubt it is hereby declared that, in no case the amount of set-off or refund on any purchase of goods shall exceed the amount of tax in respect of the same goods, actually paid, if any, under this Act or any earlier law, into the Government treasury

except to the extent where purchase tax is payable by the the claimant dealer on the purchase of the said goods effected by him:

Provided that, where tax levied or leviable under this Act or any earlier law is deferred or is deferrable under any Package Scheme of Incentives implemented by the State Government, then the tax shall be deemed to have been received in the Governnment Treasury for the purposes of this sub-section.

(6) Where at any time after the appointed day, a dealer becomes entitled to a refund whether under any earlier law or under this Act, then such refund shall first be applied against the amount payable, if any, under any earlier law or this Act and the balance amount, if any, shall be refunded to the dealer."

The case of the Petitioner

8. The Petitioner has submitted before the Court that (i) The selling dealer collects tax on behalf of the purchasing dealer and only acts as an agent of the Government to collect tax on the sale consideration; (ii) Under Section 86 a registered dealer who sells goods has to issue to the purchaser a tax invoice containing inter alia the details of its registration certificate, description, quantity and the price of the goods sold and the amount of tax charged; no further requirement has been imposed on the purchasing dealer such as obtaining from the vendor a challan supporting the payment of tax shown in the tax invoice, nor is the

purchasing dealer given the authority to obtain a challan or return from the selling dealer; (iii) The purchasing dealer cannot be held responsible if the selling dealer has failed to deposit tax in the Government Treasury and denying to the purchasing dealer the benefit of a set off on account of a failure on the part of the selling dealer to deposit tax collected, would result in imposing a condition which is impossible of compliance; (iv) The Sales tax authorities have statutory powers to assess the dealers and to recover tax including interest and penalty. The vendor can be prosecuted for non-payment of dues collected; (v) Under Rule 55 read with Section 48(2), the claimant dealer in order to claim a set off, is required to produce the original tax invoice before the Sales Tax Authority. The dealer is required to maintain accounts reflecting the date of purchase, the name of the selling dealer and his registration certificate, number of the tax invoice, purchase price of goods and the tax, if any, recovered by the selling dealer. Once these conditions are fulfilled, it is asserted that the dealer would be entitled to the benefit of a set off irrespective of whether the selling dealer has deposited the tax collected in the Treasury.

Submissions of the Petitioner

9. The challenge to the constitutional validity of the provisions of Section 48(5) is on the ground that it violates Article 14 of the Constitution. The legislative competence of the State legislature is not challenged. The challenge on the ground of Article 14 is premised on the following submissions:

(i) Section 48(5) gives unequal treatment to equals. The Act does not provide any machinery for the purchaser to ascertain whether the seller has actually paid VAT. Section 48(5) does not protect the purchaser in a case where the seller has not paid the tax into the Government Treasury which he had collected from the purchaser. This constitutes an unreasonable classification between the seller and the purchaser;

(ii) Section 48(5) is arbitrary in operation in that it contemplates disallowance of ITC claimed by the purchaser if the seller has not deposited tax into the Treasury. However, no provision for refund has been made if tax is recovered from the seller by the State in future. The claim of refund can be made only in eighteen months which is arbitrary;

(iii) Section 48(5) casts a burden on the purchasing dealer

which is impossible to perform since the Act and the Rules do not empower the purchasing dealer to seek any document from the vendor other than the tax invoices for the purchases made. Denying the purchaser of the benefit of a set off for the failure of the selling dealer to deposit the tax would be to impose a condition which is impossible to perform. Selling dealers are registered by the State and collect tax as agents for or on behalf of the State. The State has statutory powers to recover tax from a defaulting dealer by taking recourse to the coercive arm of the law, including by way of assessment, recovery, attachment and prosecution. If Section 48(5) contemplates the disallowance of ITC without the performance of the statutory duty imposed upon the State, it must be held to be unconstitutional;

(iv) Section 48(5) would cast an unbearable burden on the purchasing dealer. Though he has paid tax to the vendor, if a set off is disallowed, he would be liable to pay the same amount to the Revenue once again together with interest and penalty which may result in a closure of business contrary to Articles 14 and 19(1)(g).

10. The Petition was placed for hearing and final disposal in

a batch of Petitions challenging the constitutional validity of Section 48(5). During the course of the hearing of several companion Petitions, the State Government had filed affidavits in reply pointing out that investigation revealed the existence of Havala transactions where there was no sale of goods and the selling dealer had merely issued tax invoices to the purchasing dealer in order to defraud the Revenue and to allow the benefit of a set off. In several of those cases, this Court declined to exercise its writ jurisdiction under Article 226 of the Constitution, keeping the issue of constitutional validity of Section 48(5) open since the assessment was still to take place, during the course of which a full enquiry of facts would result. In the present proceedings as well as in the companion Petitions, it has not been the contention of the Petitioners that a claim to a set off under Section 48 should be allowed even in those cases where the transaction of sale is sham or in cases involving fraud, collusion or connivance between selling and purchasing dealers. In the present case though thre is no allegation in the reply of a havala transaction, it has been stated on affidavit by the State that a number of dealers from whom the Petitioner purchased goods are untraceable. Since we have been

called upon to decide in these proceedings, the constitutional validity of the provisions of Section 48(5), we have heard submissions of all the Counsel representing the concerned parties in support of their challenge to the validity of the provision.

11. Mr.Sridharan, Learned Senior Counsel, supported the challenge to the constitutional validity of Section 48(5) on the following grounds :

> (i) Having regard to the plain language of Section 48(5) and its legislative history, the provision has no application to a situation involving the non-payment of tax by a selling dealer in a bona fide case where there is no fraud, connivance or collusion between the selling and purchasing dealers. Section 48(5) applies only to a situation involving a variation between the rate of tax mentioned in the schedule and the actual rate contained in an exemption notification;
>
> (ii) Alternately if the benefit of a set off is denied in every case because of the non-payment of tax by the selling dealer, the provision will be rendered unreasonable and violative of Article 14;
>
> (iii) The provisions of the MVAT Act, 2002 have been enacted to provide a method of taxation which prevents a cascading effect. This in itself is in the public interest;
>
> (iv) As much as being the duty of a selling dealer to pay tax, it is the duty of the State to enforce the obligation of the selling dealer to pay tax into the Treasury. Though the purchasing dealer has paid the tax to the selling

dealer, he is yet denied the benefit of a set off which is arbitrary;

(v) The purpose of a Value Added Tax is to avoid a cascading effect and the tax is an indirect tax. The purchasing dealer does not factor the tax as a cost and what is passed on to the customer is the tax that is actually paid. Consequently, even if the immediate selling dealer has not paid tax, a set off would be available to the purchasing dealer against the tax paid in the earlier link in the chain.

Submissions on behalf of the State

12. The Advocate General appearing on behalf of the State has urged the following submissions :

i) Under Section 3 the incidence of tax is on the dealer. Every dealer is liable to pay sales tax on his transaction with the purchasing dealer;

ii) Under Section 48(1)(a) a set off is available in respect of tax paid; tax paid means tax in actual fact paid;

iii) Section 48(2) is a facility given to the purchasing dealer to get a set off even before tax is paid into the Treasury. Section 48(2), however, does not expand the scope of a set off;

iv) Set off is a concession which has been granted by the State

legislature in order to prevent a cascading effect. While granting the concession the legislature is entitled to prescribe a condition of the nature provided in Section 48(5) to the effect that in no case shall the amount of the set off exceed the amount of tax in respect of the same goods actually paid into the Government Treasury;

v) But for Section 48, there would have been no right to claim a set off. Moreover, under Section 48(1)(a) a set off can be availed of only where tax is paid and hence Section 48(5) is only clarificatory;

vi) The liability to pay sales tax on the sale consideration arises at every point where a sale takes place and the liability would be on the full amount of the sale consideration. The liability need not be passed on by the selling dealer to the purchasing dealer. The tax when collected forms a part of the sale price in view of the law laid down by the Constitution Benches of the Supreme Court. The selling dealer is not an agent of the government when he collects the tax from the purchasing dealer. The sequitur is that the purchasing dealer is liable to pay sales tax when he assumes the character of a selling

dealer who sells goods under a sale transaction. That liability is undiminished;

vii) There is no right to a set off independent of the provisions of Section 48. The grant of a set off is a matter of policy introduced to protect the ultimate consumer against a cascading effect of taxes. While granting a concession in the form of a set off, it is open to the legislature to prescribe reasonable conditions that safeguard the interests of the Revenue;

(viii) The provisions of Section 48(5) are constitutional. In fiscal and economic matters, the legislature has a large degree of latitude and the court will not readily accept a challenge to constitutionality;

(ix) Section 48(1)(a) uses the expression “paid” while Section 48(5) uses the expression “actually paid”. The Court cannot rewrite the provisions of the statute. When a provision of law is constitutional, no question of reading down the provision would arise;

(x) The power to enact tax legislation includes the power to

enact provisions that would prevent the evasion of tax. In enacting the provisions of Section 48(5) the State legislature has introduced a provision that would ensure that the benefit of a set off is granted only where the tax was in the first instance paid into the Treasury. The intention at all material times has been that a set off should be allowed only where the tax has actually been paid into the Treasury.

13. Mr. E.P. Bharucha, learned senior counsel appearing on behalf of the Sales Tax Authorities, urged that while making a switch over from a single point levy to a multi point levy under the MVAT Act 2002, the State legislature has had to balance the twin requirements of preventing a cascading effect with the necessity of enforcing compliance. In the State of Maharashtra, the set off claimed is in the amount of Rs.54,000 Crores. There are 6.5 lac registered dealers in the State. After the enforcement of the MVAT Act, 2002, with effect from 1 April 2005, the State Government introduced e-filing of returns. With the introduction of electronic returns, the operating system has been so designed so that it can detect mismatches between the claims of input credit where these

do not match with a deposit of tax in the Government Treasury. This would have been an insuperable task in the conventional manual processes but is made possible with the introduction of e-filing. Nearly 35000 notices have been issued to Hawala beneficiaries involving a quantum of nearly Rs.1,000 Crores. Nearly 3500 notices have been issued involving cases of mismatch involving a revenue of nearly Rs.700 Crores. The State has explained that it does not at an administrative level reject claims for set off merely on the ground of a mismatch. Where investigations reveal Hawala transactions or acts of fraud, collusion or connivance, steps are taken to issue summons to the selling dealers and to proceed against them by recourse to due process of law. Also, in those cases, where no element of fraud, collusion or connivance on the part of the purchasing dealer is shown the authorities would take steps to pursue the selling dealer. If the steps adopted against the selling dealer result in a recovery of the tax, a set off or refund, as the case may be, would be granted to the purchasing dealer. In other words, it has been submitted that while the provisions of Section 48(5) are constitutional and valid, the sales tax authorities would at the same time pursue cases where

selling dealers have not deposited tax in the Treasury and upon the recovery of tax would extend the benefit of a set off or refund, as the case may be, to the purchasing dealer.

The economic basis of VAT

14. The guidelines published by OECD in 2006 recognize the spread of Value Added Tax as the most important development in taxation over the last half century. Limited to less than ten countries in the late 1960s, the guidelines note that Value Added Tax had been implemented by nearly 136 countries and accounted for one fifth of the total tax revenue. The economic merit of a Value Added Tax is its ability to raise revenue in a neutral and transparent manner. The neutrality of a Value Added Tax has led to it being regarded as a preferred alternative in the context of trade liberalization. The OECD guidelines note that though legislations may vary, some of the core features of the tax regime are as follows :

- Value added taxes are taxes on consumption, paid, ultimately, by final consumers.
- The tax is levied on a broad base (as opposed to e.g., excise duties that cover specific products),

- In principle, business should not bear the burden of the tax itself since there are mechanisms in place that allow for a refund of the tax levied on intermediate transactions between firms.
- The system is based on tax collection in a staged process, with successive taxpayers entitled to deduct input tax on purchases and account for output tax on sales. Each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the proportion of tax corresponding to its margin i.e. on the difference between the VAT paid out to supplies and the VAT charged to customers. In general, OECD countries with value added taxes impose the tax at all stages and normally allow immediate deduction of taxes on purchases by all but the final consumer.

15. The White Paper on a State level Value Add Tax published under the aegis of the Empowered Committee of State Finance Ministers on 17 January 2005 took note of the fact that in the existing structure of indirect taxation, the tax regime resulted in a cascading tax burden where inputs are first taxed and after a commodity is produced with an input tax load, the output is taxed again. VAT was considered as a preferred alternative to rationalize

the overall tax burden so as to obviate the cascading effects of indirect taxation. Moreover, VAT was to replace existing systems of inspection by a system of built in self assessment by dealers and auditing, which would make the system simple and transparent. Improved tax compliance and the augmentation of revenue were important policy objectives of the system of value added taxation.

16. As an economic concept, translated into State legislation VAT subserves two important fiscal goals. First a system of taxation based on VAT obviates a cascading effect of tax burdens. This is achieved inter alia by the grant of a set off for input taxation and in respect of taxes paid on previous purchases. Second the VAT regime is also, and no less important, an instrument in promoting compliance and for broad basing the tax base. Both aspects of the regime have to be harmonized. This aspect merits importance because while interpreting the provisions of legislation, it is necessary to bring about a harmony that would preserve the balance between the need on the one hand of ensuring against a cascading tax burden and on the other hand of promoting regulatory compliance. The first element is preserved by a multi

point levy and collection of tax which allows a set off of taxes paid in the course of intermediate transactions. The second element of compliance is ensured by envisaging that every business in the supply chain is associated in the process of collecting the tax and by remitting the proportion of tax corresponding to its own margin to the government. The legislation in the present case which forms the subject matter of consideration contains specific provisions which are intended to bring about that harmony. The need for that harmony must be underscored. For it is only then that the object and purpose of the legislation can be attained.

The position of the selling dealer

17. Certain fundamental principles in regard to sales tax legislation emerge from Constitution Bench decisions of the Supreme Court. In **Tata Iron and Steel Company v. State of Bihar,**[1] a Constitution Bench of the Supreme Court, while considering the provisions of the Bihar Sales Tax Act, 1947 observed that the primary liability to pay sales tax, so far as the State is concerned, is on the seller. Though sales tax legislation

1 AIR 1958 SC 452

may permit the seller who is a registered dealer to collect the sales tax as a tax from the purchaser, that as the Supreme Court observed, does not do away with the primary liability of the seller to pay the sales tax. The Supreme Court also held that the registered dealer need not, if he so pleases or chooses, collect the tax from the purchaser and in some cases as a result of competitive conditions the dealer may find it profitable not to do so. Consequently as the Supreme Court held :

> "This also makes it clear that the sales tax need not be passed on to the purchasers and this fact does not alter the real nature of the tax which, by the express provisions of the law, is cast upon the seller. The buyer is under no liability to pay sales tax in addition to the agreed sale price unless the contract specifically provides otherwise."

18. A subsequent decision of the Constitution Bench in **George Oakes (Private) Ltd. v. State of Madras**,[2] held that when the seller passes on a tax and buyer agrees to pay the sales tax in addition to the price, "the tax is really part of the entire consideration and the distinction between the two amounts – tax and price – looses all significance from the point of view of

2 AIR 1962 SC 1037

legislative competence". The Constitution Bench held that while enacting legislation under entry 54 of List II it is not incompetent to the legislature to make the tax paid by the purchaser to the dealer together with the sale price in consideration of the goods sold a part of the turnover of the dealer; "nor does it mean that in law the tax as imposed by government is a tax on the buyer making the dealer a mere collecting agency so that the tax must always remain outside the sale price". The judgment of the Supreme Court in **Khazan Chand vs. State of Jammu and Kashmir**,[3] enunciates that the liability to pay sales tax is that of the dealer and not of the persons who purchase goods from him and for the purpose of sales tax, it is immaterial whether the price of goods has been paid to the dealer or is payable to him. The liability of the dealer to pay sales tax is irrespective of whether he has made a profit or loss in his business and whether he has received the sale price or not. The purchaser is not bound to pay sales tax payable by the vendor unless he had agreed to do so and where the purchaser agrees to pay that amount, it forms part of the sale price.

3 AIR 1984 SC 762

19. Thereafter, in a judgment of the Supreme Court in **Central Wines v. Special Commercial Tax Officer**,[4] the Supreme Court while reiterating these principles held that it is evident that "a dealer who sells the goods does not act as an agent for the State in collecting the sales tax from the persons to whom he sells the goods". The Supreme Court held that it is futile to contend that the sales tax component of the sale price charged by the vendor to the vendee is collected by him as an agent of the State Government. Even if the bill issued to the purchaser indicates the amount of sales tax separately, what is collected from him is merely a part of the sale price charged by the seller to the purchaser. The judgment in **Central Wines** reiterates that the selling dealer, even when he collects tax from the purchaser does not act as an agent for the revenue and this would not turn on whether or not the invoice does or does not reflect the amount of tax separately. The sales tax component, ruled the Supreme Court, included in the sale price is not includible in making the aggregate for the purpose of the turnover. In the decisions both of two Judge Benches of the Supreme Court in **State of Punjab vs. Atul Fasteners Ltd.**[5] and in

4 (1987) 2 SCC 371
5 (2007) 7 VST 278 (SC)

Corporation Bank vs. Saraswati,[6] there are two sentences indicating that sales tax is collected by a dealer as an agent of the State. The position of the selling dealer was, however, not an issue which arose for consideration in either of the two cases and in any event, the two decisions cannot be regarded as laying down a principle contrary to the earlier decisions of the Constitution Benches noted above.

20. In Maharashtra, the definition of the expression 'sale price' contains an explanation to the effect that it shall not include tax paid or payable to a seller in respect of a sale. The point of importance is that under the MVAT Act, 2002 the State legislature is competent to levy a sales tax on every transaction involving a sale of goods by a dealer. In a multi point levy, a charge of tax on every transaction of the sale of goods by a dealer falls within the domain of the State legislature. Value Added Tax legislation however seeks to obviate the cascading effects of a tax burden by introducing provisions for set off and refund that allow a dealer a set off against taxes paid at prior stages in a link involving

6 (2009) 19 VST 84(SC)

successive transactions.

The set off provision :

21. Section 48 empowers the State Government to frame rules to provide the circumstances in which and the conditions and restrictions subject to which a set off or refund can be granted of the tax **paid** in respect of any earlier sale or purchase of goods under the Act to a purchasing dealer. Sub section (2) of Section 48 stipulates that no set off or refund shall be granted to a dealer in respect of any purchase made from a registered dealer unless the claimant dealer produces a tax invoice. Sub section (2) further stipulates that the tax invoice must contain a certificate that the registration certificate of the selling dealer was in force on the date of sale by him and that the due tax if any payable on the sale has been paid or shall be paid and such certificate is to be signed by the selling dealer or a person duly authorized by him. Sub section (2) therefore prohibits the grant of a set off unless a tax invoice is produced by the claimant dealer containing a certificate. The three requirements of a valid certificate are firstly a certification that the registration certificate of the selling dealer was valid on the date of

the sale; secondly, that the tax due has been paid or shall be paid and thirdly, the execution of the certificate by the selling dealer or by an authorized representative. The certificate of the selling dealer is that the tax has been paid or shall be paid. 'Has been paid', would mean that the tax has already been paid by the selling dealer at or before the execution of the certificate. 'Shall be paid' is a commitment on the part of the selling dealer to deposit the tax at a future point of time.

22. Sub section (3) of Section 48 provides for a situation where no tax has been charged separately under an earlier law. In that event the rate of tax applicable for the purpose of calculating the set off or refund in respect of any earlier sale or purchase of goods is to be the rate set out against the goods in the relevant Schedule under any earlier law. Sub section (4) then provides for a situation where under a notification issued under the Act or under any earlier law any sale or purchase of goods has been exempted from the whole of the sales tax or purchase tax. In such an event for the purposes of sub section (3) the rate of tax applicable is to be nil. When the sale or purchase is exempt from the payment of a

part of the sales tax or the purchase tax, the rate of tax applicable is to be the rate at which the payment of tax is to be made by virtue of such exemption.

23. Sub section (5) is a provision which has been introduced for the removal of doubts and contains a legislative declaration to the effect that in no case would the amount of set off or refund on any purchase of goods exceed the amount of tax in respect of the same goods, actually paid, if any under the Act or any earlier law into the Government Treasury. Under the proviso to sub section (5), where the tax levied or leviable is deferred or is deferrable under a Package Scheme of Incentives implemented by the State Government, the tax shall be deemed to have been received in the Government Treasury for the purposes of the sub section.

24. Now in analysing the provisions of sub-section (5) it would be necessary to advert to its salient features. The Section contains a declaration of a peremptory nature, evidenced from the use of the words that *in no case* shall the amount of set off or refund exceed the amount of tax actually paid into the Government

Treasury. The words "in no case" are prohibitory in their intendment. The words "actually paid" are also of significance. The words "actually paid" into the government treasury signify that a claim for set off cannot be in excess of the tax in respect of which the set off is claimed that has been deposited into the treasury. The plain and natural meaning of the expression "actually paid" into the treasury is that the tax on purchases of which a set off is claimed must actually and physically have been deposited into the treasury. A constructive or notional deposit would not fulfill the mandate of the provision. The State Legislature has used language of a mandatory nature that leaves its intent beyond any doubt. The exception which is carved out in the substantive part of sub-section (5) is where a claimant dealer is liable to pay purchase tax on the purchase of the said goods effected by him. The proviso creates an exception where tax is deferred or deferrable under any Package Scheme of Incentives implemented by the State Government. In that event a deeming fiction is created by the proviso under which the tax is deemed to have been received in the Government treasury for the purposes of the sub-section. In all other cases, an actual deposit of taxes is mandated before a set off is allowed.

25. Sub-section (5) of Section 48 has not been crafted by the legislature as a proviso or as a qualificatory provision to sub-sections (3) and (4). If the legislature had intended to restrict the ambit of sub-section (5), it would have done so by a simple expedient of using words suggestive of the fact that the provision was only intended to operate in the context of sub-sections (3) and (4). Such an interpretation cannot obviously be adopted by the Court. The legislature has created a separate sub-section for the provision. But more importantly, sub-section (5) operates with an initial declaration of the intent of the legislature that it was intended for the removal of doubts. The provision must, therefore, be understood as one that operates in the context of the entirety of the scheme for set off and refund engrafted in Sub-section (5) of Section 48. The legislative mandate must be construed on a harmonious reading of all the provisions of Section 48.

26. Sub-section (5) of Section 48 had a parallel in the erstwhile provisions of Sub-section (3) of Section 42 of the Bombay Sales Tax Act, 1959. The provision came to be introduced

in the Act by a Validation Act of 1991.[7] Section 42(3) as introduced provided that for the removal of doubt it was declared that in no case would the amount of drawback, set off or refund, exceed the amount of tax in respect of the same goods paid, if any, into the Government treasury. The Statement of objects and reasons accompanying the Bill referred to the fact that set offs are claimed on goods which form the subject matter of an exemption from the payment of the whole or part of the tax payable as notified. The Maharashtra Sales Tax Tribunal in a decision in the case of **Century Plastics**[8] held that a set off should be granted at the rate mentioned in the Schedules without considering the effect of an exemption notification. The Statement of objects and reasons provided a rationale for the new provision:

> "The intention in granting set off was certainly that set off granted should have been out of the tax received. The Government would have now been faced with a queer situation where it would have had to grant set off without receiving any tax, thus resulting into loss of revenue to the State which was not intended. Therefore, with a view to protecting the revenue it was expedient to immediately amend suitably the provisions of section 42 with retrospective effect, and also to make necessary validating and saving provisions."

---

7 The Bombay Sales Tax (Amendment and Validation) Act, 1991 (Maharashtra Act 10 of 1991)

8 S.A. 464 of 1990 decided on 21 September 1990

The legislative intent underlying the previous provision was to give effect to the legislative mandate that a set off should be granted out of tax received.

27. The legislature did not contemplate the grant of a set off without any tax being received into the Government Treasury. The grant of a set off without the receipt of tax into the treasury would result in a loss of revenue, a consequence which the provision for set off does not contemplate.

28. The purpose of a set off is to obviate a cascading effect of the tax burden on the ultimate consumer. This element of legislative policy is to be balanced with the need for securing tax compliance and ensuring against a loss of legitimate revenue owing to Government. The balance between the two considerations is drawn by ensuring that while a set off is available in respect of the purchase tax paid on the same goods at an earlier stage, the set off is based on the actual payment of tax into the government treasury. Even considering the legislative history of the erstwhile

provisions contained in Section 42(3) of the Bombay Sales Tax Act, 1959, it is evident that the legislative intent was not only to confine it to a case such as **Century Plastics**. The plain language of Section 48(5) of the MVAT Act, 2002, cannot be controlled by the Statement of objects and reasons accompanying the introduction of a Bill pertaining to a provision contained in an earlier legislation. But we have also traced the legislative history of the earlier provision as well (since it was relied upon by the Petitioner) in order to establish the fundamental precept that a set off arises out of the tax which has been deposited in the Government Treasury.

29. A set off constitutes a concession granted by the legislature. In the absence of a set off under Section 48(5), the selling dealer would be liable under the charging provision of the MVAT Act, 2002 to pay tax on the sale consideration. There is no independent right to a set off apart from Section 48. The entitlement to a set off is created by the taxing statute and the terms on which a set off is granted by the legislation must be strictly observed.

30. In **Godrej & Boyce Mfg. Co. Pvt. Ltd. vs. Commissioner of Sales Tax**,[9] the Supreme Court while considering the provisions for the grant of a set off under Rule 41(9) of the Bombay Sales Tax Rules, 1959, explained the rationale for a set off as follows:

> "A manufacturing dealer like the appellant pays purchase tax when he purchases raw material and he is again obliged to pay the sales tax when he sells the goods manufactured by him out of the said raw material. Tax on both the transactions has the inevitable effect of increasing the price to the consumers besides adversely affecting the trade. It is for this reason that the aforesaid Rule enables the manufacturing dealer to claim set off of the tax paid by him on the purchase of raw materials from out of the tax payable by him on the sale of goods manufactured from out of the said raw material."

The judgment of the Supreme Court enunciates that (i) The dealer has no legal right to claim a set off of the purchase tax paid and of input credit from the sales tax payable on the sale of goods manufactured by him; (ii) The entitlement to a set off flows only out of the rules; (iii) The grant of a set off is in the nature of a concession; and (iv) It is open to the legislature while granting the concession to restrict or curtail the extent of the entitlement as a condition attaching to the concession. The Supreme Court

9 (1992) 3 SCC 624

observed as follows :

> "In law (apart from Rules 41 and 41-A) the appellant has no legal right to claim set off of the purchase tax paid by him on his purchases within the State from out of the sales tax payable by him on the sale of the goods manufactured by him. It is only by virtue of the said Rules – which, as stated above, are conceived mainly in the interest of public – that he is entitled to such set off. It is really a concession and an indulgence. More particularly, where the manufactured goods are not sold within the State of Maharashtra but are despatched to out -State branches and agents and sold there, no sales tax can be or is levied by the State of Maharashtra. The State of Maharashtra gets nothing in respect of such sales effected outside the State. In respect of such sales, the rule-making authority could well have denied the benefit of set off. But it chose to be generous and has extended the said benefit to such out-State sales as well, subject, however to deduction of one per cent of the sale price of such goods sent out of the State and sold there. We fail to understand how a valid grievance can be made in respect of such deduction when the very extension of the benefit of set off is itself a boon or a concession. It was open to the rule-making authority to provide for a small abridgment or curtailment while extending a concession."

31. The same principle has been emphasized in a recent judgment of a Constitution Bench of the Supreme Court in **Commissioner of Central Excise vs. Hari Chand Gopal**:[10]

> "The law is well settled that a person who claims exemption or concession has to establish that he is

10(2011 1 SCC 236

> entitled to that exemption or concession. A provision providing for an exemption, concession or exception, as the case may be, has to be construed strictly with certain exceptions depending upon the settings on which the provision has been placed in the statute and the object and purpose to be achieved. If exemption is available on complying with certain conditions, the conditions have to be complied with. The mandatory requirements of those conditions must be obeyed or fulfilled exactly, though at times, some latitude can be shown, if there is a failure to comply with some requirements which are directory in nature, the non-compliance of which would not affect the essence or substance of the notification granting exemption."

32. In **India Agencies vs. Additional Commissioner of Commercial Taxes, Bangalore**,[11] a Bench of three Learned Judges of the Supreme Court emphasized that the provision under the State Rules for furnishing the original Form-C in order to claim a concessional rate of tax under Section 8(1) of the Central Sales Tax Act, 1956, is mandatory. Before the Supreme Court, it was urged by the assessee that there was no suggestion that there was anything wrong with the genuineness of the transaction in which case there was no basis to reject the claim for a concessional rate of tax. The Supreme Court observed that the condition on which the concession was granted was mandatory and a liberal view could

11 (2005) 2 SCC 129

not be taken merely on the ground that there was hardship to the dealer. Issues of hardship, ruled the Supreme Court, are for the legislature to consider. In that context, the Supreme Court observed as follows:

> "We also realise that the section and the rules as they stand may conceivably cause hardship to an honest dealer. He may have lost the declaration forms by pure accident and yet he will be penalised for something for which he is not responsible but it is for the legislature or for the rule-making authority to intervene to soften the rigour of the provisions and it is not for this Court to do so where the provisions are clear, categoric and unambiguous."

Constitutionality of fiscal legislation :

33. While dealing with a challenge to the constitutional validity of the provisions of Section 48(5) on the ground that it violates Article 14 of the Constitution, the Court which exercises the power of judicial review must be conscious of the limitations of judicial intervention, particularly in matters relating to the legitimacy of economic or fiscal legislation. While enacting fiscal legislation, the legislature is entitled to a great deal of latitude. The Court would interfere only where a clear infraction of a constitutional provision is established.

34. There are several reasons for the doctrine of judicial deference which has emerged in the area. Firstly, the doctrine of deference is an emanation of the presumption of constitutionality which attaches to a law which is enacted by the competent legislature. A written Constitution such as ours, does confer judicial power on the Courts to expound the Constitution. Judicial review can extend to striking down legislation which infringes constitutional provisions. But, in exercising that power, when they are called upon to determine the validity of legislation, Courts must realize that the constitutional function of enacting legislation is conferred in a democratic polity on the legislature which consists of elected representatives. In a classical democratic system of checks and balances a fine balance is drawn by the constitution between the enacting power of legislature and the reviewing power of the judiciary. The reviewing power of the Court seeks to preserve the eternal values which form the basis of the constitutional document. The object of judicial review is not to second guess the legislature, but to ensure that the legislature has not transgressed constitutional boundaries.

35. The second reason for the judicial tradition is a precept which recognizes the need for expertise in matters of economic policy and fiscal legislation. These are matters where the legislature and the executive draw upon a resource of expert advice. Some times, as debates on several contemporary economic issues would indicate, even experts tend to differ. Differences between experts are foreshadowed by differences in conceptual thinking as much as by differences in ideology. When they exercise restraint in tax and economic matters, Judges only reiterate the conventional wisdom that policy making, ideology and the differences which arise out of conflicting interests in society are best left to be resolved by democratically accountable bodies. Democratically elected institutions are responsible for the consequences of their policy choices. The choices which have to be made between competing fiscal and economic policies are not neutral in terms of social impact. Those choices do affect social outcomes and the distribution of resources. In economic and fiscal matters, policy making involves an element of trial and error. Policies have to be shaped to adapt to a rapidly changing

environment. That is an area which Courts do not enter for sound and rational considerations which have weighed with successive generations of Judges.

36. In **R.K. Garg vs. Union of India**,[12] a Constitution Bench of the Supreme Court while adverting to the judicially recognized and accepted presumption of constitutionality observed that the burden is on the person who attacks the constitutionality of a statute to establish a clear transgression of constitutional principle. On the power of judicial review in regard to economic and fiscal issues, the Supreme Court observed as follows :

> "Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It has been said by no less a person than Holmes, J. that the legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrinaire or strait-jacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. The court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human rights are involved. Nowhere has this admonition been more

12 (1981) 4 SCC 675

felicitously expressed than in Morey v Doud (354 US 457 : 1 L Ed 2d 1485 (1957) where Frankfurter, J. said in his inimitable style:

> In the utilities, tax and economic regulation cases, there are goods reasons for judicial self-restraint if not judicial deference to legislative judgment. The legislature after all has the affirmative responsibility. The courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the judges have been overruled by events – self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability.
>
> …
>
> There may even be possibilities of abuse, but that too cannot of itself be a ground for invalidating the legislation, because it is not possible for any legislature to anticipate as if by some divine prescience, distortions and abuses of its legislation which may be made by those subject to its provisions and to provide against such distortions and abuses. Indeed, howsoever great may be the care bestowed on its framing, it is difficult to conceive of a legislation which is not capable of being abused by perverted human ingenuity. The Court must therefore adjudge the constitutionality of such legislation by the generality of its provisions and not by its crudities or inequities or by the possibilities of abuse of any of its provisions. If any crudities, inequities or possibilities of abuse come to light, the legislature can always step in and enact suitable amendatory legislation. That is the essence of pragmatic approach which must guide and inspire the legislature in dealing with complex economic issues."

In a classical statement of law, a Constitution Bench of the Supreme Court in **East India Tobacco Co. vs. State of Andhra Pradesh**,[13] observed that when a classification which is made by legislation is challenged as being discriminatory, it is for the person who assails the legislation to establish that it is not based on a valid classification. The burden, observed the Supreme Court, is all the heavier when the legislation under attack is a taxing statute, since the power of the legislature in classifying objects for the purposes of taxation are wide. The legislatures possess the greatest freedom in classification and the burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it. More recently, in **Government of Andhra Pradesh vs. P.Laxmi Devi**,[14] the Supreme Court observed as follows :

> "The court must, therefore, make every effort to uphold the constitutional validity of a statute, even if that requires giving the statutory provision a strained meaning, or narrower or wider meaning, than what appears on the face of it. It is only when all efforts to do so fail should the court declare a statute to be unconstitutional."

13 AIR 1962 SC 1733
14 (2008) 4 SCC 720

37. Legislative entries in the Seventh Schedule to the Constitution have to be read in a broad and comprehensive sense to include all subsidiary and ancillary matters. An entry which authorises the imposition of a tax, such as Entry 54 of List II, also authorises an enactment which prevents the tax imposed being evaded. As a Constitution Bench of the Supreme Court observed in **Baldeo Singh vs. Commissioner of Income Tax,**[15] "If it were not to be so read, then the admitted power to tax a person on his own income might often be made infructuous by ingenious contrivances. Experience has shown that attempts to evade the tax are often made."

38. As a matter of constitutional interpretation, it is a settled principle of law that while interpreting legislation, it is the duty of the Court to interpret legislation as it stands and the Court must give effect to the policy of the legislature as reflected in the ordinary and natural meaning of the words used. In a recent judgment in **Shankar Raju Vs. Union of India**,[16] the Supreme

15 AIR 1961 SC 736 para 20 page 742
16 2011 (271) E.L.T. 492 (SC)

Court observed thus:

> "Where the Legislature clearly declares its intent in the scheme of a language of a statute, it is the duty of the Court to give full effect to the same without scanning its wisdom or policy and without engrafting, adding or implying anything which is not congenial to or consistent with such express intent of legislature. Hardship or inconvenience cannot alter the meaning employed by the legislature if such meaning is clear on the face of the statute. If the statutory provisions do not go far enough to relieve the hardship of the member, the remedy lies with the Legislature and not in the hands of the Court."

There is no occasion for a Court to read down a statute which is constitutional. The rule of reading down is used for the limited purpose of making a particular provision workable and to bring it in harmony with other provisions of the statute. However, in the garb of reading down a provision, it would not be open to the Court to read into it words and expressions not found in the statute. (**Union of India vs. IND Swift Laboratories Ltd**.).[17]

39. Section 48(5) uses the expression "actually paid" into the government treasury. The words "actually paid" must receive their ordinary and natural meaning. A set off under Section 48(5)

17 2011 (265) E.L.T. 3 (SC)

would be allowable only to the extent of the tax, if any, that has been actually paid into the treasury in respect of the purchase tax paid on the same goods. The use of the word "actually" in conjunction with the word "paid" leaves no manner of doubt about the legislative intent. A set off is available where tax has been deposited in the treasury and to the extent of the tax deposited. Where no tax has been deposited in the treasury, there is no tax actually paid in respect of which a set off can be granted. In **State of Madhya Pradesh vs. Indore Iron and Steel Mills Pvt. Ltd**.,[18] the Supreme Court considered the provisions of a notification issued under the Madhya Pradesh General Sales Tax Act, 1958 which contained a condition that the goods "had suffered entry tax" under a particular enactment before they were purchased by the registered dealer. Interpreting the words "suffered entry tax", the Supreme Court held that it is only where the entry tax had actually been paid that the exemption would arise:

> "In our view, the words of the said notification under the State Sales Tax Act are so clear that they leave no doubt whatsoever and cannot be subjected to any construction but one, namely, that only goods upon which entry tax under the Entry Tax Act has been paid are entitled to the exemption thereunder. There has to be actual payment.

18 AIR 1998 SC 3050

> The impact of the entry tax upon the goods for which the exemption is sought has to be felt; only then is the exemption available. The use of the word "suffered" makes this plain."

There is no reason for the Court to depart from the plain and ordinary meaning of the words "actually paid", when used in the context of Section 48(5).

40. The expression "paid" must have a contextual meaning, obtaining content from the nature of the statutory provision in which it has been used. In **N.B.Sanjana, Assistant Collector of Central Excise, Bombay vs. Elphinston Spinning & Weaving Mills Co.Ltd.**,[19] the Supreme Court considered the meaning of the expression "paid" and "short levied" in Rule 10 of the Central Excise Rules, 1944. Rule 10 provided for the recovery of duties or charges short levied or erroneously refunded. The Supreme Court noted, that taken literally, the word "paid" means actually paid in cash. The Supreme Court held that in Rule 10, the expression "paid" should not be read in a vacuum and it will not be right to construe the word literally, which means actually paid. The Court

19 AIR 1971 SC 2039

observed that in Rule 10, the expression 'paid' has been used to denote the starting point of limitation of three months for the issue of a written demand. If the literal construction that the amount should have been actually paid was accepted, then in a case where no duty has been levied, the Department would not be able to take any action under Rule 10. Therefore, in that context, the Supreme Court held that the proper interpretation to be placed to the expression “paid” is “ought to have been paid”.

41. In **Sulekh Ram and Sons vs. Union of India,**[20] a Single Judge of the Delhi High Court considered a Central Excise exemption notification which exempted from the payment of excise duty iron and steel products falling under sub-item 1(a) of Item 26AA of the First Schedule to the Central Excise Act made from rerollable scrap on which appropriate amount of excise duty has already been paid. The Petitioner purchased untested rails from Hindustan Steel Limited. The excise authority issued a notice of demand on the Petitioner on the ground that the duty had not been paid. The Delhi High Court held that the purchaser of the goods

20 1978 (2) ELT (J525) (Del)

from the manufacturer was entitled to rely upon the excise system and to presume that duty had already been recovered from the manufacturer, since he would have no means of knowing whether excise duty had already been paid by the manufacturer before the sale of the goods. In view of this context, the Delhi High Court held that the words "already paid" would mean that the excise duty must have been paid at the prior stage or ought to have been paid at the prior stage. This judgment of the Delhi High Court was affirmed by the Supreme Court in **Collector of Central Excise vs. Decent Dyeing Co**.[21]

42. In the context in which the words "actually paid" are used in the MVAT Act, "actually paid" means what has been as a matter of fact deposited in the treasury. Hence, in the context of the provisions of Section 48(5), we cannot accept the contention of the Petitioner that "actually paid .. in the government treasury" means or should be read to mean what tax ought to have been deposited but has not actually been deposited in the treasury. To accept the submission would be to rewrite the legislative provision.

21 1990(45) E.L.T. 201 (SC)

Moreover, the concept of a set off presupposes that tax has been paid in respect of the goods in respect of which a set off is claimed. To allow a set off though the tax has not been paid actually would be to defeat the legitimate interests of the Revenue. Hence, in the overall statutory scheme of Section 48; sub-section (5) has a rational basis and foundation. The liability to pay tax is that of the selling dealer. As the Constitution Bench held in **TISCO** and in **George Oakes**, whether the tax is passed on by the selling dealer to the purchasing dealer is a matter of their contractual understanding. Once that is the position that has held the field in our jurisprudence for over fifty years and has been reiterated in **Khazan Chand** and **Central Wines** by the Supreme Court, a dealer cannot obviate his liability to pay tax on his sale transaction, by claiming a set off and placing the responsibility to recover tax on an earlier link in the chain on the Revenue. To test the constitutionality of Section 48(5) one must ask oneself whether the legislature has acted discriminatorily or whether the provision is facially or ex facie discriminatory. Neither is the object or effect of Section 48(5) discriminatory. The State legislature was not bound to grant a set off. If the legislature had not granted a set off, that

would not have a bearing on its competence or on constitutionality, since a tax on the sale of goods falls within the purview of Entry 54. In granting a set off, the legislature can impose conditions and that imposed in Section 48(5) is not lacking in rationality. Moreover, the scheme for set off in Section 48 has to be read in its entirety and as one cohesive whole. The legislature cannot be compelled to grant a set off, ignoring the conditions which it imposes. The conditions are not severable and are part of one integrated scheme.

43. Under Section 48(1), the State Government is by rules, empowered to provide for the grant of a set off or refund of the whole or any part of the tax paid in respect of any earlier sale or purchase of goods under the Act to the purchasing dealer. Under sub-section (2), a set off or refund cannot be granted to a dealer in respect of a purchase made from the registered dealer unless the claimant produces a tax invoice containing a certificate that the registration certificate of the selling dealer was in force on the date of sale by him and the due tax, if any, payable on the sale has been or shall be paid and unless the certificate is signed by the selling dealer or by an authorised representative. Sub-section (2) of

Section 48 allows a facility to a registered dealer to claim a set off on the basis of a tax invoice containing a certificate of the selling dealer in the terms as indicated. Section 86 details the requirements of a tax invoice. Under Rule 55, no set off or refund can be granted unless the conditions which are prescribed in that provision are fulfilled. The particulars which are to be certified in the tax invoice, bill or cash memorandum are further elaborated upon in Rule 77. The provisions of Section 48(2) have to be harmoniously construed with the provisions of Section 48(5). Entitlement to a set off, subject to compliance with the provisions of sub-section (2), is defeasible in the event that purchase tax on the goods has not been actually paid into the Government treasury. All the provisions form part of one composite scheme. All the provisions of Section 48 have to be construed harmoniously. One part of Section 48 cannot be read disjointed from the rest. The legislature would not have intended to allow one part of its scheme for set off without the rest. To obliterate one part would do violence to the entirety.

44. In **State of Madras vs. Radio and Electricals Ltd.**[22] the Supreme Court considered the provisions of Section 8(1) of the Central Sales Tax Act, 1956 and the Registration and Turnover Rules, 1957. The issue was whether, upon a purchasing dealer in one State furnishing a Form-C declaration to the selling dealer in another State, certifying that the goods purchased were covered by the certificate of registration obtained by the purchasing dealer and were intended for resale, or use in the manufacture of goods for sale and that declaration was produced by the selling dealer, was it open to the Sales Tax Authority to deny to the selling dealer the benefit of a concessional rate under Section 8(1) on the ground that the goods were incapable of being used for the purpose for which they were declared to be purchased. The Supreme Court observed that the scheme of the Rules and the Act is that the purchasing dealer as well as the selling dealer must register themselves. If declared goods were specified in the certificate of registration of the purchasing dealer and if it was certified that the goods were intended for resale by him, the sale was subject to a concessional rate of tax under Section 8(1). The seller could have

22 1966(18) STC 222 (SC)

no control over the purchasing dealer and all that he has to satisfy himself is that the purchaser is a registered dealer and that the goods purchased are specified in a certificate. Once these two matters were duly satisfied, the selling dealer was under no further obligation to oversee the application of the goods for the purpose for which it was represented that the goods were intended to be used. The Supreme Court held as follows :

> "If the purchasing dealer misapplies the goods he incurs a penalty under section 10. That penalty is incurred by the purchasing dealer and cannot be visited upon the selling dealer. The selling dealer is under the Act authorised to collect from the purchasing dealer the amount payable by him as tax on the transaction, and he can collect that amount only in the light of the declaration mentioned in the certificate in Form 'C'. He cannot hold an enquiry whether the notified authority who issued the certificate of registration acted properly, or ascertain whether the purchaser, notwithstanding the declaration, was likely to use the goods for a purpose other than the purpose mentioned in the certificate in Form 'C'. There is nothing in the Act or the Rules that for infraction of the law committed by the purchasing dealer by misapplication of the goods after he purchased them, or for any fraudulent misrepresentation by him, penalty may be visited upon the selling dealer."

45. In **Chuni Lal Parshadi Lal vs. Commissioner of Sales**

Tax[23], the issue which fell for consideration was whether the dealer could be declared as non-taxable on sales of yarn which he made against III-A forms issued under the U.P. Sales Tax Act, 1948 though the purchaser instead of selling yarn in the same condition had consumed the same. The Supreme Court held as follows :

> "An interpretation which will make the provisions of the Act effective and implement the purpose of the Act should be preferred when possible without doing violence to the language. The genuineness of the certificate and declaration may be examined by the taxing authority but not the correctness or the truthfulness of the statements. The sales tax authorities can examine whether certificate is "farzi" or not, or if there was any collusion on the part of selling dealer – but not beyond – i.e., how the purchasing dealer has dealt with the goods. If in an appropriate case it could be established that the certificates were "farzi" or that there was collusion between the purchasing dealer and the selling dealer, different considerations would arise."

46. These decisions deal with the use of the goods by the purchasing dealer subsequent to the sale and hold that the selling dealer could not be held liable for an act of the purchasing dealer in the use or application of the goods subsequent to the sale. Moreover, neither of the two cases involved a constitutional challenge to a provision such as Section 48(5) of the MVAT Act

23 (1986) 62 STC 112

under which set off cannot exceed in any case, the tax actually paid in the treasury on the same goods.

47. In the **State of Maharashtra vs. Suresh Trading Company**,[24] the Respondents who were registered dealers had purchased goods from a registered dealer who had issued invoices containing a certificate that the registration of the selling dealer was in force on the date of the sale. The Respondents upon reselling the goods, claimed to deduct from their turnover of sales, the resales of the goods which had been purchased by them. The Assessing Officer disallowed the claim on the ground that the registration of the dealer from whom the Respondents had purchased goods had been cancelled with retrospective effect. The Supreme Court held that the purchasing dealer was entitled in law to rely upon the certificate of registration of the selling dealer and the retrospective cancellation of the registration certificate of the selling dealer would have no effect upon any person who had acted upon the strength of a registration certificate when the registration was current. **Suresh Trading** holds that the retrospective

24 (1998) 109 STC 439 (SC)

cancellation of a registration certificate does not affect transactions carried out during its validity, on the strength of the certificate. In **ITC Ltd. vs. Commissioner of Central Excise**,[25] the Supreme Court has dealt with declarations which are required to be furnished under diverse statutes, thus :

> ".. declarations required under diverse statutes have different characteristics and consequences depending upon the nature of the declaration. A declaration may be (1) an assurance of an existing state of affairs or (2) an assurance of a future course of conduct by the declarant himself or (3) a statement of required conduct by a third party. In the first two kinds of declarations the onus is on the declarant to make good the declaration. In other words the truth of the declaration may be verified. But when all that is stated in the declaration is a requirement to be fulfilled by another, what is to be enquired into is the compliance with the requirement and not the correctness of the declaration itself."

48. The decision of the Punjab and Haryana High Court in **Gheru Lal Bal Chand vs. State of Haryana,**[26] arose on a challenge to the provisions of Section 8(3) of the Haryana Value Added Tax Act, 2003. Section 8(3) was to the following effect :

> "S.8 Determination of input tax. - (1) and (2) ….
>
> (3) Where any claim of input tax in respect of any goods sold to a dealer is called into question in any

25 2004(171) E.L.T. 433 (SC)
26 (2011) 45 VST 195 (P&H)

> proceeding under this Act, the authority conducting such proceeding may require such dealer to produce before it in addition to the tax invoice issued to him by the selling dealer in respect of the sale of the goods, a certificate furnished to him in the prescribed form and manner by the selling dealer; and such authority shall allow the claim only if it is satisfied after making such inquiry as it may deem necessary that the particulars contained in the certificate produced before it are true and correct."

The Punjab and Haryana High Court held that while the genuineness of a certificate and a declaration may be examined by the taxing authority, the onus cannot be placed on the assessee to establish the correctness or the truthfulness of the statements recorded therein. The High Court held that the Department must allow the claim once a proper declaration is furnished. In the event of its falsity, the Department can proceed against the defaulter when the genuineness of the declaration is not in question. However, an exception has been carved out in the event that fraud, collusion or connivance is established between the registered purchasing dealer or the immediate preceding selling dealer or the earlier dealer in the chain. The judgment of the High Court did not involve a challenge to a provision such as Section 48(5) of the MVAT Act, 2002. We may only note with the

greatest respect and deference that while the High Court has relied upon the observations contained in the decisions of the Benches of two Learned Judges of the Supreme Court in **Atul Fasteners** and in **Corporation Bank**, the earlier decisions of the Constitution Benches in **TISCO** and in **George Oakes** were not perhaps drawn to the attention of the Court. Moreover, the decision in **Elphinston Spinning** which construed the word "paid" in Rule 10 of the Central Excise Rules involved an issue of short levy. Finally we may note that a provision such as Section 48(5) which uses clear and express words such as that in "no case" shall a set off exceed the tax "actually paid" in the government treasury did not fall for consideration.

49. The State Government has placed before the Court, both on affidavit and during the course of the hearing, the steps which it shall pursue against a selling dealer who, having collected tax from the purchasing dealer does not deposit the tax into the Government Treasury. The Value Added Tax in the State of Maharashtra was introduced with effect from 1 April 2005 under the MVAT Act, 2002. The Act replaces a single point levy of tax under the Bombay

Sales Tax Act, 1959 for a multi point levy of tax. Under the MVAT Act, 2002, VAT is levied at every stage. A set off or input credit of tax paid on purchase is granted to the claimant dealer. This resulted in an increase in the number of dealers claiming input credit. The Revenue has disclosed that for financial year 2010-11, the claim on account of input credit was Rs.54,251 crores. In this background, the grant of input credit requires proper verification in order to ensure that taxes are received in the Government Treasury. The filing of true and correct returns by dealers assumed importance as under the VAT regime assessment is by way of exception. The State of Maharashtra was one of the first States in the country to introduce e-filing in 2008. Registration, filing of returns, making of payments and the submission of audited statements (in Form e-704) is in the electronic form. For that purpose a new software has been developed and deployed since 2010-11. As a result of electronic filing the system can generate (i) A list of short filing; and (ii) A list of non-filing of returns. The electronic system generates a mis-match list for the purpose of ascertaining the claim of input tax credit. The mis-match list in turn, consists of:

(i) A negative list where the vendor has not deposited the tax;

(ii) A positive list where the input credit is allowable to the claimant dealer; and

(iii)Cases where returns are not filed, where input credit is not allowed to a claimant dealer unless the default is made good by the vendor. Both in the case of the negative list where there has been a short filing of taxes and in a situation where returns have not been filed by the vendor, the State Sales Tax Department conducts an enquiry in regard to the vendor. In cases of Havala transactions, recovery action and/or prosecution is initiated against such suppliers. On the other hand, where the enquiry reveals that the supplier is a genuine dealer, but there has been a short filing of taxes or returns, recovery is initiated against the selling dealer and/or an assessment is made. Where the selling dealer has not filed returns, an order of assessment is passed under Section 23. Section 23(1) provides for an assessment where a registered dealer fails to file a return in respect of any period by the prescribed date. Under sub-section (2) of Section 23, the Commissioner is empowered to issue a notice to a dealer even where a return is filed where he considers that an enquiry is necessary to ensure that the

return is correct and complete. If a default has not been rectified, recovery action and/or prosecution is initiated. Section 74 provides for offences. Where the dealer has not submitted audited reports in Form e-704, penalty proceedings are initiated under Section 61(2). The Court has been informed that if in any of the above three situations, a default is made good by the supplying dealer (vendor), input tax credit to that extent of the default which has been made good, shall be allowed to the claimant dealer either in appeal or by way of assessment and/or review.

50. The regime of electronic filing generates data pertaining to a web of complex transactions. The system of tax collection, assessment and refunds can move towards a more objective and transparent process with the deployment of electronic and digitised processes. The system is capable of providing transparent and accountable governance for the tax payer. It allows authorities to investigate transactions which in the manual processes followed in an earlier era would have been difficult or complex. Electronic filing of returns, payments and audited statements would enable a matching process to be carried out between the input credit

claimed by way of a set off and the tax which has been deposited by the selling vendor. During the course of the hearing of these proceedings, the Court has been informed that corrective action shall be taken to allow an additional claim of input tax credit to a claimant dealer even where it has been initially disallowed by the Department. The State sales tax department has stated before the Court that while the electronic system is being continuously evolved, the following steps are being taken to promote greater transparency and efficient handling of claims for input tax credit:

(a) At the end of each financial year, the Sales Tax Department will reconcile the data on its system and inform the dealer about the input tax credit which may have become available on reconciliation, allowing the claimant dealer to seek an additional claim of refund to the extent of his input tax credit so matched in such cases; and

(b) The Department shall, during the course of the current year set up a Dealer Information System (DAS) and Dealer Ledger account showing the status of the taxes collected and paid

on the web portal of the Maharashtra State Sales Tax Department (www.mahavat.gov.in) in order to facilitate the process of the grant of additional claim of input credit to claimant dealers.

51. The Learned Advocate General appearing on behalf of the State has tendered a statement of the steps that would be pursued against defaulting selling dealers :

> 1) The Sales Tax Department will identify the Defaulters namely, registered selling dealers who have not paid the full amount of tax due in the Government Treasury either by not filling their returns at all or by filing returns but not paying the full tax due (i.e. "short filing") or where returns are filed but sales to the concerned dealers are not shown (i.e. "undisclosed sales").
>
> 2) Set off will be denied to dealers where at any stage in the chain of sales a tax invoice/certificate by a Defaulter is or has been relied on :
>
> a) In the event of no returns having been filed by the Defaulter, the dealers will be denied the corresponding set off;
>
> b) In the case of short filing, dealers who have purchased from the Defaulter will be granted set off pro rata to the tax paid;
>
> c) In the case of undisclosed sales, the dealers will be denied the entire amount being claimed as set off in relation to the undisclosed sale;
>
> d) To prevent a cascading effect, the tax will be recovered only once. As far as possible, the Sales Tax Department will recover the tax from

the dealer who purchases from the Defaulter. However, the Sales Tax Department will retain the option of denying a set off and of pursuing all selling dealers in the chain until recovery is ultimately made from any one of them.

3) The full machinery of the Act will be invoked by the Sales Tax Department wherever possible against Defaulters with a view to recover the amount of tax due from them, notwithstanding the above. Once there is final recovery (after exhaustion of all legal proceedings) from the Defaulter, in whole or part, a refund will be given (after the end of that financial year) to the dealer(s) claiming set off to the extent of the recovery. This refund will be made pro rata if there is more than one dealer who was denied set off;

4) Refund will be given by the Sales Tax Department even without any refund application having been filed by the dealers, since the Sales Tax Department will reconcile the payments, inform the dealer of the recovery from the Defaulter concerned and grant the refund;

5) Details of Defaulters will be uploaded on the website of the Sales Tax Department and dealers denied set off will also be given the names of the concerned Defaulter(s);

6) The above does not apply to transactions by dealers where the certificate/invoice issued is not genuine (including hawala transactions). In such cases, no set off will be granted to the dealer claiming to be a purchaser;

7) The above should not prevent dealers from adopting such remedies as are available to them in law against the Defaulters.

52. This case highlights the complexity of the issue with which both the legislature and tax administrators must grapple in devising a tax regime governed by the Value Added Tax. The legislature has performed a balancing exercise between the need on the one hand of ensuring the interests of the ultimate consumer by obviating a cascading tax burden and on the other hand, securing governance under rule of law principles which promote transparency and certainty while at the same time protecting the legitimate revenues of the State. The Value Added Tax regime has replaced a single point levy with a multiple point levy in which every dealer is a vital link in the levy and collection of tax. As the number of dealers has increased manifold, conventional systems of tax administration have to be replaced by web based electronic systems. The system which the administrator must devise must continuously evolve both with a view to simplify procedures and to make the process including that relating to beneficial provisions such as set off and refund objective and transparent. The judgments of the Supreme Court, including in **R.K.Garg**, recognise

the latitude which the law confers upon the Legislature and the executive to experiment with new systems in cases involving fiscal and economic policy. Systems have to evolve as experiences result in shared learning and as technology keeps abreast of changing needs.

53. In the view which we have taken in these proceedings, the constitutionality of the provision of Section 48(5) is upheld. Similarly Section 51(7) which requires an application for refund and specifies the period within which an application can be made, cannot be assailed as being invalid. Regulating the process of refunds is as much within the province of a legitimate tax enactment and the legislature is within its power in requiring a refund to be applied for within a reasonable period. The right to obtain a set off is a right conferred by statute and the legislature while recognizing an entitlement to a set off in certain circumstances is lawfully entitled to prescribe the conditions subject to which a set off can be obtained. If the legislature, as in the present case, prescribes that a set off should be granted only to the extent to which tax has been deposited in the treasury on the

purchase of goods, it is within a reasonable exercise of its legislative power in so mandating. This does not offend Article 14. A plea of hardship cannot result in the invalidation of a statutory provision in a fiscal enactment which is otherwise lawful. At the same time, we have set out in detail the assurance which has been placed before the Court by the State Revenue in the present case of the steps that would be taken to pursue recoveries against selling dealers who have either not filed returns or, having filed returns have not deposited the tax collected from the purchasing dealer in whole or in part.

54. For the reasons indicated earlier, we do not find any merit in the challenge to the provisions of Section 48(5) of the MVAT Act, 2002. We decline to accede to the prayer for reading down the provisions of Section 48(5). The order of assessment is subject to the remedy of an appeal in the course of which it would be open to the Petitioner to pursue the remedy available in law. As regards the recoveries to be made from the selling dealers, the State government and the sales tax authorities shall abide by the assurance and statement recorded in the judgment. The Petition

shall accordingly stand disposed of. There shall be no order as to costs.

(Dr.D.Y.Chandrachud, J.)

(R.D.Dhanuka, J.)