

Fragmentation of supply – no duty on electricity but the controversy awaits

The 101st amendment to the Constitution (COI) was a path-breaking event. It substantially altered the constitutional framework of indirect taxes in India. It's been 4 years since the GST is implemented, and there are already several landmark judgments from Supreme Court and High Courts interpreting the constitutional aspect one or the other way.

Recently, another constitutional controversy came up before the Hon'ble Tripura High Court in [ONGC Tripura Power Company Ltd. vs State of Tripura](#), held Section 4 (4) of the Tripura Electricity Act, 2019 as unconstitutional to the extent it sought to impose Electricity Duty on the inter-state sales of Electricity. The ruling seems to have inadvertently kick-started a battle which can create number of undesired consequence. We start by giving some background into the 101st amendment, how it left a looping hole, and what else area may get impacted.

States not empowered to impose tax on inter-state sales: Before the 101st amendment, Entry 53 and Entry 54 of the State List authorized the States to impose taxes on consumption/ sale of electricity and sale of goods subject to Entry 92A of Union List. Further, Article 286 prohibited the states to impose tax on the sale of goods outside the state. Therefore, there was two-way embargo upon the states to not impose tax on inter-state sales one under Entry 54 itself relevant and one under Article 286 (which was applicable to both Entry 53 and Entry 54). In sum and substance, it was held in [State of AP vs NTPC](#) that states are not empowered to impose electricity duty on inter-state sale of electricity.

After the 101st amendment, the embargo was maintained to limited products covered in Entry 54 by inserting an express exclusion in the entry itself i.e. *“not including sale in the course of inter-state trade or commerce”*. Similar exclusion was however not carried out in Entry 53. Further, Article 286 was slightly modified with the words “supply of goods or services” replacing “sales of goods”.

Essentially, therefore, the embargo on Entry 53 is lifted, Article 286 is held to be inapplicable on Entry 53. **But, the embargo can be retained if Article 286 can be ready into Entry 53 by construing ‘supply’ to inter alia include “sale or consumption”**. And that's how the Hon'ble Tripura High Court interpreted, and held that the State of Tripura is not competent to impose Electricity duty on the sale of electricity to other states.

Fragmentation of Supply: The hidden impact of reading Article 286 into Entry 53 is allowing fragmentation of the expression 'supply' into 'sales', and so many other elements that the expression 'supply' can capture. Section 7 (1) (a) of the CGST Act for example includes 'sale, transfer, barter, exchange, license, rental, lease or disposal, etc. If the supply can be fragmented like this, both the Parliament and Legislature of State would have independent and separate power to impose separate taxes (other than GST) under the aegis of Article 246A.

Separate tax on sale of goods by State: The Hon'ble Gujarat High Court in [Reliance Industries vs State of Gujarat](#) probably had foreseen the absurd consequences, and had categorically enunciated that the fragmentation of the "supply" cannot into different components held permissible for the State legislature to assume the power to impose independent tax on the sale of goods without reference to the Goods and Services Tax Council [para 90]. Although the Gujarat High Court had read other restraints also (notably Article 279A) into State's power to impose tax under Article 246A(2), however, these restraints are merely procedural not could easily be complied by the States while legislating under Article 246A (2). The ONGC ruling to this extent appendage the stance of State Legislatures in case they want to legislate a separate tax on intra-state sale of goods or services, in the future.

Impact on Article 248(2) [Equalization levy]: Another impact of fragmentation of supply into various other elements lies deep into Parliament's power to impose taxes not mentioned in any of the List in Article 248 (2). Remember that as per Article 248 (1), the power to impose tax under Article 248 (2) is subject to Article 246A i.e. if power to imposed tax is covered under Article 246A, that power cannot be exercised under Article 248 (2).

Let's recall the report of the CBDT Committee on equalization levy (2016), wherein the committee offered that the power to impose equalization levy is covered by Entry 92C or Entry 97. Now on the pretext that supply can be fragmented to cover the taxable event of 'equalization levy'¹, it would mean that such power can be exercised by Parliament only under Article 246A, therefore the so-called resort to Entry 92C and 97 would not be available. Essentially, therefore, the fragmentation of supply into services would have the consequence

¹ Taxable event of equalization levy (EL) of 2016 is consideration of specified 'service' [Section 165 (1) of Finance Act, 2016]. Similarly taxable event of EL of 2020 is consideration of e-commerce supply of service [Section 165 (1) of FA 2016]

of potential invalidation of equalization levy so much so that the procedure specified in Article 246A was not followed.

More sanctity into imposition of Cess: In [UOI vs Mohit Mineral Pvt Ltd.](#), the Hon'ble Supreme Court in upholding the Parliament's power to impose compensation cess, fell on Article 270 and Article 246A. With due respect to the Court's verdict, the tracing of power to impose compensation cess under Article 270 is little doubtful considering this Article 270 *ipso facto* does not give power to 'prescribe for the imposition of taxes', but rather it governs the distribution of taxes.

Further, the tracing of power to impose tax under Article 246A was also controversial such that it ended up being further expanding "power to make laws with respect to goods and service tax". But by allowing fragmentation of the term 'supply' in Article 246A would give unchallengeable, it would easily pave way for imposition of Cess. Therefore, the fragmentation as elaborated above, further augment the State's power to impose cess.

Electricity duty under wheeling agreement: Another obvious consequence of fragmentation of supply into sale would be invalidation of electricity duty imposed by States on the electricity wheeled by captive power generation units when the consumption unit is located outside the state.

Conclusion: In addition to the above consequences, that may seem not imaginable as of now. But in substance, it can be said that, while the ruling saves the assessee from the electricity duty, but can open flood gates. It would be appropriate that all glaring oversights in Constitutional amendments be identified and curative actions are taken either through the legislative act or some other possible measure.

Thank You
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