

# Territorial nexus - A trump card in VAT

Maharashtra VAT leviable on sales of goods in territorial waters



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## Introduction

1. Laws of State Legislature must confine to persons, properties, transactions or objects situated within the boundaries of State. What if a sale occurs outside territorial boundaries of a State? Obvious answer would be that such sale is not subjected to State's sales tax law. The Parliament or the State Legislature cannot be presumed to have exceeded their territorial powers, since every legislation is supposed to be territorial in its operation. Well, it is not the case always as State can tax even if there is sufficient territorial connection. Recently Bombay High Court held otherwise in case of *Raj Shipping v. State of Maharashtra* [2015] 62 taxmann.com 309.

## Background of the case - *Raj Shipping v. State of Maharashtra*

2. Assessee was engaged in business of supplying fuels ("bunker supplies") to shipping vessels located in territorial waters of India, off the coast of Maharashtra. Shipping vessels placed purchase order for fuel to assessee. Assessee, in turn, placed purchase order on oil marketing companies (OMCs). OMCs transported fuel to barge loading point where fuel was decanted in cargo tanks of barges owned by assessee. After taking delivery of fuel from OMCs, the barges sailed to the anchorage point of shipping vessels and unloaded fuel in vessel.

There was no dispute on the fact that the Sales tax was leviable on sale of motor spirit but sales of motor spirit at retail outlet are exempt. But assessee claimed exemption from payment of MVAT on sale of HSD and did not pay sales tax. It also contended that sale transactions executed were not within the territorial jurisdiction of the State of Maharashtra.

But department alleged that it had wrongly claimed the deduction and show cause notice was issued. The issue was whether such sale in territorial waters adjacent to territory of Maharashtra would be subjected to Maharashtra VAT Act?

### Doctrine of territorial nexus

3. State legislation must be confined to persons and objects within the territorial limits of the State but it does not mean that a State legislation would be struck down if the legislation has any connection with any person, object or activity outside the State. For levying tax it is not necessary that the sale should take place within the territorial limits of the State. The tax could be levied if all the ingredients of sale like the agreement to sell, the passing of title, and delivery of goods have a territorial connection. The courts would require the State to establish a relationship between the purpose of legislation and the territorial connection. This is called the doctrine of territorial nexus. A State law is not invalid so long as there is a sufficient nexus between the State making the law and the subject-matter of legislation.<sup>1</sup>

Thus, a State may levy a tax on a person, property, object or transaction not only when it is situated within its territorial limits, but also when it has a sufficient and real territorial connection with it. Whether in a given case there is sufficient territorial nexus or not is a question of fact, and it is for the Courts to decide in each case whether "the territorial nexus" being put forward as the basis of the application of the law is "sufficient" or not.<sup>2</sup>

There is no general formula defining what territorial connection or nexus is sufficient or necessary for application of the law to a particular object. Sufficiency of the territorial connection involves consideration of two elements, viz.:

1. the connection must be real and not illusory; and

2. the liability sought to be imposed under the Act must be pertinent or relevant to that connection.<sup>3</sup>

A transaction of sale is a composite transaction and consists of legal ingredients like agreement of sale, passing of title and delivery of goods but it is not necessary for the purpose of legislative jurisdiction that all legal ingredients of sale or even the transfer of title should have taken place inside the Province. It is sufficient if there is a proper territorial nexus or connection between the taxing authority and the transaction sought to be taxed.<sup>4</sup>

Applicability of the theory of nexus to sales tax legislation had been clearly recognised by Supreme Court in array of judgments. In the case of *Tata Iron & Steel Company v. State of Bihar* AIR 1958 SC 452, the Supreme Court held that although the tax was on a completed sale, one or more of the several ingredients constituting the sale could furnish the connection between the taxing statute and the sale. Existence of the goods within the State at the time of contract of sale and in the case of sale by the producer or manufacturer, the production or manufacture of goods in the State were held to be sufficient nexus to sustain the legislation impugned.

Also in case of *Tikaram & Sons (supra)*, the Apex Court held that "a transaction of sale is a composite transaction and consists of legal ingredients like agreement of sale, passing of title and delivery of goods but it is not necessary for the purpose of legislative jurisdiction that all legal ingredients of sale or even the transfer of title should have taken place inside the Province. It is sufficient if there is a proper territorial nexus or connection between the taxing authority and the transaction sought to be taxed. The fact that the goods are manufactured in the province of constitute a real and pertinent nexus or connection which confers jurisdiction upon the Provincial Legislature to impose the tax".