

EY Tax Alert

SC judges differ on invocation of doctrine of legitimate expectation with respect to sales tax incentive

Executive summary

This tax alert summarizes a recent ruling of the Supreme Court (SC)¹ on invocation of doctrine of legitimate expectation against removal of exemption granted to persons engaged in blending of tea under the West Bengal Sales Tax Act, 1994.

In 1999, a tax holiday was granted to new small scale industrial units for a specified period. As per the scheme, such units were exempt from payment of sales tax on purchase of raw materials used in manufacturing activity.

Relying upon the said scheme, assessee had set up a unit for manufacturing blended tea and was granted an eligibility certificate for a period of seven years by the Deputy Commissioner for claiming sales tax exemption.

The definition of the term "manufacture" in the West Bengal Sales Tax Act, 1994 was subsequently amended to remove blending of tea from its ambit. Consequently, the eligibility certificate was modified and exemption from payment of sales tax granted to assessee was discontinued.

Assessee challenged the aforesaid action/ amendment before the Tribunal. The order dismissing the appeal was further challenged before the Calcutta High Court (HC) which confirmed the Tribunal's order. Aggrieved by the same, assessee preferred an appeal before the SC.

The judges of the division bench of SC differed in their verdict. The first judge agreed to the decision of the HC and concluded that the assessee was not entitled to exemption once it ceases to be the manufacturer. Further, the assessee's argument on the principles of legitimate expectation had no substance.

However, the second judge observed that a legitimate expectation lured the assessee to set up a unit, under the assumption that the State authority would hold true to its promise, act in a fair manner and abide by the decision made by it. The said expectation was then snatched away without any appropriate justification. Therefore, the benefit of exemption should be available to the assessee for the period promised by Revenue.

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¹ TS-217-SC-2023



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Background

- ▶ The term “manufacture” was originally defined in section 2(dd) of the erstwhile Bengal Finance (Sales Tax) Act, 1941 which included “blending of any goods”.
- ▶ The said Act was replaced by the West Bengal Sales Tax Act, 1994 and in April 1998, the definition of “manufacture” provided under Section 2(17) was amended to cover only “blending of tea” within its ambit instead of “any goods”.
- ▶ By virtue of the above amendment, tax holiday was granted to new small scale industrial units for a specified period.
- ▶ Subsequently, the West Bengal Incentive Scheme, 1999 was implemented. As per the said scheme, the new manufacturing industrial units which were established after complying with all the requirements, were given an exemption from payment of sales tax on purchase of raw materials required for carrying the manufacturing activity.
- ▶ Relying upon the above scheme, assessee had set up a new small scale industrial unit for manufacturing blended tea and was granted an eligibility certificate for a period of seven years by the Deputy Commissioner to claim the said exemption.
- ▶ The definition of the term “manufacture” was further amended with effect from 1 August 2001 whereby the words “blending of tea” was omitted. Consequently, the exemption from payment of sales tax, which was granted to the assessee was discontinued and even the eligibility certificate was required to be modified.
- ▶ Assessee challenged the aforesaid amendment before the Tribunal wherein its application was dismissed and the same was confirmed by the Calcutta High Court (HC). Aggrieved by the same, assessee preferred an appeal before the Supreme Court (SC).

Assessee's contentions

- ▶ It had set up new industrial unit in expectation of getting benefit of tax for a period on fulfilment of certain requirements and once such unit is given the benefit, subsequently by way of amendment, such right cannot be taken away.
- ▶ The State authority has in a blanket manner simply removed the word “blending of tea” from the definition of “manufacture” without considering the fact that the assessee had received eligibility certificate for a period of seven years and had already availed the benefit of the scheme for a certain period.

Its rights were crystalized from the day eligibility certificate had been granted and the only justifiable way the State could have rescinded this benefit was to show overarching public interest, which in present case, has not been demonstrated by the State.

- ▶ The doctrine of legitimate expectation can be invoked where the amendment under the provision of law is not made in consonance with public interest. In the present case, the Revenue has failed to showcase any public interest in rescinding the benefits.
- ▶ The impugned amendment is an arbitrary move by the State. Any decision taken in an arbitrary manner contradicts the principle of legitimate expectation.
- ▶ The State action fails to meet the test of reason and relevance, as no explanation has been given by the State for rescinding the benefits.
- ▶ Since the assessee had made substantial expenses for availing the benefits under the scheme, the State cannot take away such benefits. The said act done by the State is unfair and abuse of power against the assessee.
- ▶ Reliance was placed on various rulings to support the above contentions².

Revenue's contentions

- ▶ Assessee ceased to be a manufacturer upon the impugned amendment in the definition of “manufacture” and therefore was not entitled to the benefit of exemption.
- ▶ The legislature in its wisdom, excluded “tea blending” from the definition of “manufacture”, therefore the same cannot be regarded as a manufacturing activity entitled to enjoy exemption. Therefore, the submissions made by the assessee has no substance.
- ▶ As rightly observed and held by the HC, this is not a case of “vested right” but a case of “existing right”. The existing right can be taken away. There cannot be any legitimate expectation against a statute.
- ▶ To grant the exemption or not is a policy decision and nobody can claim the exemption as a matter of right. The learned Tribunal and HC have rightly refused to grant the assessee any exemption from payment of sales tax which was being granted prior to the impugned amendment.
- ▶ This is not the case of retrospective operation but a case of prospective withdrawal of an existing continuing right to get exemption of sales tax and

² (2016) 6 SCC 766, (2006) 8 SCC 702, (1979) 2 SCC 409, Civil Appeal Nos. 3860-3862 of 2020 and (2000) 4 SCC

the same being a policy decision is not subject to judicial review³.

First judge's observation

- ▶ Granting or withdrawing of an exemption is always within the domain of the State, which falls within the policy decision and as per the settled position of law, unless withdrawal is found to be so arbitrary, the Court would be reluctant to interfere with such a policy decision.
- ▶ There cannot be any promissory estoppel against the statute as per the settled position of law. This is not a case of "vested right" but a case of "existing right" which can be varied or modified and/or withdrawn.
- ▶ The word "manufacture" is very relevant and is a condition *sine qua non* to be satisfied in view of Section 39 of the Act under which the said exemption is claimed by the assessee. Therefore, if a dealer ceased to be the manufacturer, he shall not be entitled to the benefit of exemption under Section 39.
- ▶ Accordingly, pursuant to the impugned amendment by which "tea blending" is excluded from the definition of "manufacture", assessee shall not be entitled for the exemption from payment of sales tax and accordingly dismissed the appeal.

Second judge's observation

- ▶ In the present case, two substantial questions of law have been raised, viz.:
 - ▶ Whether the assessee has a vested right in claiming exemption from payment of sales tax under the Act?
 - ▶ Whether the doctrine of legitimate expectation is applicable in the present case?
- ▶ On the first question, the assessee does not have any vested right in claiming exemption from payment of Sales tax. However, it has to be analyzed whether doctrine of Legitimate Expectation is applicable in the present case.
- ▶ The doctrine of legitimate expectation is a legal principle that arises when a public authority makes a promise or acts in a manner that leads an individual or a group to expect a particular outcome. This doctrine, which flows from the doctrine of rule of law, is based on the idea of fairness and consistency in the decision-making processes of public authorities.
- ▶ When a legitimate expectation of a specific outcome is created by a public authority, the said public authority is required to consider such expectation

created by it when making a decision that affects the interests of the individual or group concerned.

If the public authority fails to do so, the individual or group has a right to challenge the decision and seek a remedy, such as an order to enforce the legitimate expectation, as in the present case.

- ▶ The Doctrine of Legitimate Expectation was conceptualized and recognized by the various Courts of United Kingdom.
- ▶ In the Indian jurisprudence, there are contrary judgments wherein the said doctrine has been interpreted differently. In all the judgments that discuss the limitations of legitimate expectation, what is most important is the principle that public interest is supreme.
- ▶ Legitimate expectation can be inferred against a statute, provided that such a claim of legitimate expectation is in public interest, and for a statute to claim a bar against legitimate expectation, it must demonstrate that the shift in policy is for the advancement of public interest.
- ▶ If a blanket bar on the invocation of legitimate expectation against a statute is adopted, then the State can entice persons and institutions to act in a certain manner with the expectation of a certain outcome, and suddenly, without any demonstration of public interest, rescind the same. Such a scenario, if allowed to manifest into reality, would remove all certainty of the legal system, and directly become an antithesis to the rule of law.

Further, no domestic or foreign investor would ever invest in local business and ventures, as any legitimate expectation by way of a statute would translate only to a façade, as such a benefit could be snatched away arbitrarily at any point in time.

Hence, any contrary interpretation of the doctrine of legitimate expectation, would cause great havoc, and only cause detriment to the rights of individuals and the society at large.

- ▶ Doctrine of legitimate expectation and of promissory estoppel are two separate principles, and as such, the blanket ban on promissory estoppel against a statute cannot be applicable to the former doctrine.
- ▶ The doctrine of promissory estoppel is a remedy in private law, but the doctrine of legitimate expectation is a remedy in public law and is rooted in Article 14 of the Constitution of India.
- ▶ Such a distinction between public law and private law becomes important, because once a law enters the public sphere, it affects the rights of the society, and thus, becomes liable to a stricter level of scrutiny and susceptible to judicial review.
- ▶ To bring clarity to the scope and limitations of the doctrine of legitimate expectations, it is essential to

³ (2007) 4 SCC 737

chart out the following principles for the application of legitimate expectations:

- ▶ The expectation must be reasonable.
- ▶ The expectation must be based on a clear representation made by public authority.
- ▶ The representation must be made by an authorized person.
- ▶ The representation must be legitimate and not against any law or policy.
- ▶ The public interest must be demonstrated if an expectation is taken away on the grounds of public interest.
- ▶ Public interest must supersede change in policy.
- ▶ The expectation must be based on a legitimate interest.
- ▶ The expectation must be protected.
- ▶ From an understanding of the facts, it can be clearly seen that the tax holiday granted to small scale industries involved in the manufacture and blending of tea, created a legitimate expectation in favor of the assessee herein.

Such a legitimate expectation lured the assessee to pour their hard-earned money into setting up small scale industrial units, under the assumption that the authority would hold true to its promise, act in a fair manner and abide by the decision made by it.

The said expectation was then snatched away, leaving the assessee without remedy, and in losses.

- ▶ To justify such a shift in policy, the public authority must demonstrate the reasons for such a shift. It can be clearly seen that no such appropriate justification has been provided in the present case.
- ▶ In such a circumstance, the legitimate expectation created in the mind of the assessee must be protected, and the benefits given originally must be made applicable to the assessee for the period promised by the Revenue.
- ▶ Accordingly, the authority must be held accountable to the legitimate expectation created by it, and therefore, a direction is issued to the Revenue to extend the benefit of exemption to the assessee till the expiry of such a benefit as per the eligibility certificate.

Comments

- a. In view of the divergent opinions, the matter is likely to be placed before the Chief Justice of India for constituting an appropriate bench.
- b. The second judge has reiterated the principle that doctrine of legitimate expectation cannot be invoked only when the changes/ amendment is carried out in public interest.
- c. This ruling may be relevant for businesses who would have commenced availing the benefit of State/ Central incentives, but the same were subsequently rescinded, curtailed or withdrawn.

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