

# DOCTRINE OF TERRITORIAL NEXUS

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## INTRODUCTION

The distribution of powers is an essential feature of federalism. The object for which a federal state is formed involves a division of authority between the National Government and separate states. The tendency of federalism to limit on every side the action of the government and to split up the strength of the state among co-ordinate and independent authorities is especially noticeable, because it forms the essential distinction between a federal system. And a unitary system of Government. " A Federal Constitution establishes the dual polity with the union at the centre and the states at a periphery, each endowed with sovereign powers to be exercised in the field assigned to them respectively by the constitution." "The one is not subordinate to the other in its own field, the authority of one is co-ordinate with that of other". In fact, the basic principle of federation is that the legislative, executive and financial authority is divided between the centre and state not by any law passed by the centre but by constitution itself. This is what Indian constitution does.

**Territorial nexus** is a concept described in Article 245 of the Constitution of India that determines how legislative powers are divided. "Article 245 provides, inter alia, that (subject to the provisions of the Constitution).

(i) Parliament may make laws for the whole or any part of the territory of India and (ii) the legislature of a State may make laws for the whole or any part of the State.

(b) Thus, article 245 sets out the limits of the legislative powers of the Union and the States from the geographical (or territorial) angle. From the point of view of the subject matter of legislation, it is article 246 which is important. Article 246 reads as under:

"246(1) Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List 1 of the Seventh Schedule (in this Constitution, referred to as the "Union List"). (2) Notwithstanding anything in clause (3), Parliament, and subject to clause (1), the Legislature of any State also, shall have power to make laws with respect to any of the matters enumerated in List III in the Seventh Schedule (in this Constitution, referred to as the "Concurrent List"). (3) Subject to clauses (1) and (2), the Legislature of any State has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule (in this Constitution, referred to as the "State List").

(4) Parliament has power to make laws with respect to any matter for any part of the territory of India not included in a State, notwithstanding that such matter is a matter enumerated in the State List".

1. Article 245 (2) of the Constitution of India makes it amply clear that '*No law made by Parliament shall be deemed to be invalid on the ground that it would have extra-territorial operation*'. Thus a legislation cannot be questioned on the ground that it has extra-territorial operation.

2. It is well-established that the Courts of our country must enforce the law with the machinery available to them; and they are not entitled to question the authority of the Legislature in making a law which is extra-territorial.

2. Extra-territorial operation does not invalidate a law. But some nexus with India may still be necessary in some of the cases such as those involving taxation statutes.

## OBJECTIVES

1.To analyze the legislative powers conferred by the Indian constitution

2.To study about the division of powers in the legislature in relation to the doctrine of territorial nexus.

## HYPOTHESIS

The legislature has not exceeded its constitutional powers given under the constitution of India.

## RESEARCH METHODOLOGY

The researcher has collected the information from secondary sources.

## CHAPTERISATION

1. The Doctrine of territorial nexus.
2. Doctrine of territorial nexus in the Indian legislature.

## CHAPTER I: THE INDIAN LEGISLATION

### LEGISLATIVE RELATIONS

The constitution of India makes two fold distribution of legislative powers.

- A. With respect to territory
- B. With respect to subject matter.

As regards territory Article 245(1) provides that subject to the provisions of this constitution, parliament may make laws for the whole or any part of the territory of India. According to clause 2 of Article 245 a law made by parliament shall not be deemed to be invalid on the ground that it

has extra-territorial operation, i.e. takes effect outside the territory of India<sup>1</sup>. In *A.H. Wadia v. Income tax Commissioner, Bombay*, the Supreme Court Held : “In the case of a sovereign Legislature question of extra-territoriality of an enactment can never be raised in the municipal court as a ground for challenging its validity. The legislation may offend the rules of international law, may not be recognized by foreign courts, or there may be practical difficulties in enforcing them but these are questions of policy with which the domestic tribunals are concerned.”<sup>2</sup>

**THEORY OF TERRITORIAL NEXUS** The Legislature of a state may make laws for the whole or any part of has extra-territorial operation i.e. takes effect outside the state.<sup>3</sup>

However, there is one exception to this general rule. A state law of extra-territorial operation will be valid if there is sufficient nexus between the object and state<sup>4</sup>. In *Wallace v. Income tax Commissioner, Bombay* a company which was registered in England was a partner in a firm in India. The Indian Income tax Authorities sought to tax the entire income made by the company. The privy council applied the doctrine of territorial nexus and held the levy tax valid. It is said that the derivation from British India of a major part of its income for a year gave to a company for that year sufficient territorial connection to justify its being treated as at home in India for all purposes of tax on its income for that year from whatever source income may be derived. If there is sufficient nexus between the person sought to be charged and the state seeking to tax him, the taxing statute would be upheld. But illusory and the liability sought to be imposed must be pertinent to that connection.<sup>5</sup> Whether there is sufficient connection is a question of fact and will be determined by courts in each accordingly.

### **Territorial Nexus and the State Legislature**

The Legislature of a State may make laws for the whole or any part of the State. Now, this leaves it open to scrutiny whether a particular law is really within the competence of the State Legislature enacting it. There are plethoras of cases that have stated that the laws which a state is empowered to make must be for the purpose of that State.<sup>6</sup>

Thus, the Doctrine of Territorial Nexus has been applied to the States as well. There are two conditions that have been laid down in this respect The Connection (**nexus**) must be real and not illusory. The liability sought to be imposed must be pertinent to that connection.

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1. *constitution of India, Mahendra Pal Singh, Eastern book publications, p. 206.*

2. *A.H. Wadia v. commissioner of income tax, (1948) 51 BOMLR 287.*

3. <http://constitutionallaw2006.blogspot.in>, 12/02/2017, 20:00 AM.

4. *Kochuni Vs. State of Madras, AIR 1960 SC 1080 pg. 5*

5. *Wallace bros. v. commissioner of income tax (1943) 45 BOMLR 929.*

6. *LEGISLATIVE RELATION BETWEEN UNION AND STATES, SUBAS .H. MAHTO, P. 21.,*  
<http://www.shareyouressays.com/115277>, 12/02/2017, 22:00 AM.

If the above two conditions are satisfied, any further examination of the **sufficiency of Nexus** cannot be a matter of consideration before the courts.

In various cases relating to taxation statutes, the courts have time and again stated that it is not necessary that the sale or purchase should take place within the Territorial Limits of the State. Broadly speaking local activities of buying or selling carried in the State in relation to local goods would be sufficient basis to sustain the taxing power of the State, provided of course, such activities ultimately result in concluded sale or purchase to be taxed.

There is also a Presumption of Constitutionality that the **Legislature is presumed not to have exceeded its constitutional powers** and a construction consistent with those powers is to be put upon the laws enacted by the Legislature.

### **Extra-Territorial Operation**

It is well-established that the Parliament is empowered to make laws with respect to aspects or causes that occur, arise or exist, or maybe expected to do so, within the territory of India and also with respect to extra-territorial aspects or causes that have an impact or nexus with India.

“Such laws would fall within the meaning, purport and ambit of grant of powers of Parliament to make laws ‘for the whole or any part of the territory of India’ and they may not be invalidated on the ground that they require extra territorial operation. Any laws enacted by the Parliament with respect to extra territorial aspects or causes that have no nexus with India would be *ultra vires* and would be laws made for a foreign territory.”<sup>7</sup>

This clearly indicates that as long as the law enacted by the Parliament has a nexus with India, even if such laws require extra territorial operation, the laws so enacted cannot be said to constitutionally invalid. It is only when the ‘*laws enacted by the Parliament with respect to extra territorial aspects or causes that have no nexus with India*’ that such laws ‘would be *ultra vires*.’

What is an acceptable Nexus is again a subjective question. Professor Michael Lang in his book ‘Introduction to the Law of Double Taxation Conventions’ says that “*in International law practice, there are no significant limits on the tax sovereignty of states. In designing the domestic personal tax law, the national legislator can even tax situations when, for example, only a "genuine link" exists. It is only when neither the person nor the transaction has any connection with the taxing state that tax cannot be levied*”<sup>8</sup>.

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7. <http://shodhganga.inflibnet.ac.in>, 24/02/2017, 10:00 AM.

8. Introduction to the Law of Double Taxation Conventions, Michael Lang, Linde publication, p.441.

In granting the Parliament the powers to legislate 'for' India, and consequently also with respect to extra-territorial aspects or causes, the framers of our Constitution certainly intended that there be limits as to the manner in which, and the extent to which, the organs of the State, including the Parliament, may take cognizance of extra-territorial aspects or causes, and exert the State powers (which are the powers of the collective) on such aspects or causes.

Doctrine of Public Trust requires that all legislation by the Parliament with respect to extraterritorial aspects or causes be imbued with the purpose of protecting the interests of, the welfare of and the security of India, along with Article 51, a Directive Principle of State Policy, though not enforceable in a court of law, nevertheless fundamental to governance, lends unambiguous support to the conclusion that Parliament may not enact laws with respect to extra-territorial aspects or causes, wherein such aspects or causes have no nexus whatsoever with India<sup>9</sup>.

## CHAPTER II : DOCTRINE OF TERRITORIAL NEXUS IN INDIAN LEGISLATION

Article 245-Extent of laws made by parliament and by the legislatures of states

1. Subject to the provisions of this constitution, Parliament may make laws for the whole or any part of the territory of India, and the legislature of a state may make laws for the whole or any part of the state.
2. No law made by parliament shall be deemed to be invalid on the ground that it would have extra-territorial operation.<sup>10</sup>

Subject to the provisions of this constitution, this phrase means that the power enjoyed by the parliament to make laws for the whole or any part of the territory of India will be read in subject to other provisions of the constitution. In other words, this power is not absolute. Other provisions like the distribution of powers, fundamental rights and other provisions of the constitution as interpreted by the courts.

“Extra- territorial operation” – Law made to operate outside territorial limits of India.

State laws would be void if it has extra- territorial operation i.e., takes effect outside the state. However, there is one exception to this general rule. A state law of extraterritorial operation will be valid if there is sufficient nexus between the object and the state. This is clarified by the case *State of Bombay vs. R.M.D.C.*<sup>11</sup>

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9. *constitution of India, Mahendra Pal Singh, Eastern book publications, p. 331.*

10. *constitution of India, Mahendra Pal Singh, Eastern book publications, p. 332.*

11. *State of Bombay vs. R.M.D.C, 1957 AIR 699, SCR 874.*

**The Doctrine of Territorial nexus can be invoked under the following circumstances-**

- Whether a particular state has extra-territorial operation.
- If there is a territorial nexus between the subject- matter of the Act and the state making the law.

*It signifies that the object to which the law applies need not be physically located within the territorial boundaries of the state, but must have a sufficient territorial connection with the state.*

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.

***State of Bombay vs RMDC***

The Respondent was not residing in Bombay but he conducted Competitions with prize money through a newspaper printed and published from Bangalore having a wide circulation in Bombay. All the essential activities like filling up of the forms, entry fees etc for the competition took place in Bombay. The state govt. sought to levy tax the respondent for carrying on business in the state.

The question for decision before the Supreme Court was if the respondent, the organiser of the competition, who was outside the state of Bombay, could be validly taxed under the Act.

Decision-It was held that there existed a sufficient territorial nexus to enable the Bombay Legislature to tax the respondent as all the activities which the competitor is ordinarily expected to undertake took place mostly within Bombay.

***Tata Iron And Steel Company vs. Bihar State***<sup>12</sup>

Tax Act for levy of sales tax whether the sale was concluded within the state or outside if the goods were produced, found and manufactured in the state. The court held there was sufficient territorial nexus and upheld the Act as valid. Whether there is sufficient nexus between the law and the object sought to be taxed will depend upon the facts and circumstances of a particular case.

It was pointed out that sufficiency of the territorial connection involved a consideration of two elements a) the connection must be real and not illusory b) the liability sought to be imposed must be pertinent to that connection.

**The Doctrine of Territorial Nexus governs the taxation of non-residents**

The Hon'ble SC ('SC') in the case of *Shrikant Bhalchandra Karulkar v. State of Gujarat* dealt with the legislative competence to make laws having extra territorial operation in view of the provisions of Article(s) 245 and 246 of the Constitution of India. It was held that so long as the law made by State legislature is applicable to the persons residing within its territory and to all things and acts within its territory, it cannot be considered extra-territorial<sup>13</sup>.

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12. *Tata Iron And Steel Company vs. Bihar State*, 1958 AIR 452 SCR 1355.

13. *Shrikant Bhalchandra Karulkar v. State of Gujarat*, 1994 SCC (5) 459, JT 1994 (5) 91.

The legal insight into "nexus" came in various rulings. For example, in the case of *State of Bihar and Ors. v. Shankar Wire Products Industries and Ors.*,<sup>14</sup> the Bihar Weight and Measures (Enforcement) Act, 1959 required verifying and stamping of weights on demand of fees. These weights were manufactured in Bihar but were meant for sale and delivery in other States. The SC held that since the verification and stamping is on the weights manufactured in the State, it is irrelevant where the weights are sold i.e. in the State or outside the State<sup>15</sup>. The provisions of stamping have been enacted to protect the interests of the consumers. In the interests of consumers and keeping in view the object of the legislation, the weights should be verified and stamped at the very inception at the place where they are manufactured. The SC thus upheld territorial legislative competence of the State Legislature in verifying and stamping the weights.

The determination of territorial nexus qua levy of income-tax came up for adjudication as early as in 1943 before the Privy Council in the case of the *Patiala State Bank*. The Patiala State Bank, which was the appellant in the instant case, was owned and controlled by the Maharaja of Patiala. The appellant carried on banking business with the head office and all of its branches situated in that State and no part of the business of the appellant was carried on in British India. During the assessment year in question, the appellant took over a property situated at Mussoorie (which was a part of British India) from its debtor who was a subject of the Patiala State, in part satisfaction of a loan advanced to him. Further, the appellant also collected and received in British India through the hands of its agents, sums representing the interest on certain Government of India securities that it had acquired in the course and for the purposes of its business.

Both the income received by the appellant from its investments in British India and income received from the Mussoorie property were held to be income arising in connection with a trade or business carried on in British India and therefore liable to be assessed to tax.

## CONCLUSION

The Legislature of a state may make laws for the whole or any part of has extraterritorial operation i.e. takes effect outside the state. However, there is one exception to this general rule. A state law of extra-territorial operation will be valid if there is sufficient nexus between the object and state. The power to make a law having extra territorial operation is conferred only on Parliament and not on the state legislatures. Hence an Act of the State Legislature, if it gives extra-territorial operation to its provisions, can be successfully challenged in the court, unless extra-territorial operation can be sustained on the ground of territorial nexus. It means that although the object to which the law applies may not physically be located within the territorial limits of a State, yet the State law will be valid if there exists a connection or nexus between the state and the object. Territorial nexus is not confined within the boundaries of India but can be applied overseas.. The law that is prevalent in India comes into force at that time. Territorial nexus is a doctrine that allows application of the law of a nation outside its territorial boundaries and it is basically an International law.

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14. *Woodman Industries And Ors. vs State Of Bihar And Ors.* on 4 October, 1999, 2000 CriLJ 1075.

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