A COMMISSIONER OF INCOME TAX AND ANR.

v.

M/S DISTILLERS CO. LTD.

APRIL 5, 2007

B [S.B. SINHA AND MARKANDEY KATJU, JJ.]

Income Tax Act, 1961—s.43-B—Tax deduction—On the amount paid for non-compliance of a Circular specifying process of bottling of arrack—
C *Assessing Authority denying the deduction holding that the amount was a penalty and the same was not permissible in terms of s.43-B—Appellate Authority, Tribunal and High Court held that the amount was neither a penalty, nor a fee nor excise duty (tax) and s.43-B was not applicable in this case—On appeal, held: The amount was not an excise duty as the same was not for manufacturing of arrack—Tax could not have been levied in terms of*
D *executive circular—It was neither a penalty as the non-compliance was not of a statutory provision—s.43-B is not applicable in this case—Assessee entitled to tax deduction on the amount—Karnataka Excise Act, 1965—Karnataka Excise (Manufacturing and Bottling of Arrack) Rules, 1987—Rule 14(3)—Constitution of India, 1950—Article 265, Seventh Schedule List II Entry 8 and 51.*

E

Respondent-assessee was in the business of arrack bottling, manufacture of industrial alcohol and their marketing, under a licence in terms of Karnataka Excise Act, 1965. Karnataka Excise (Manufacturing and Bottling of Arrack) Rules, 1987 stated that Arrack after blending would be
F **matured in the manner and for the period as would be specified by the Commissioner of Excise. The Commissioner, by a circular, specified a period of 15 days for the arrack to be matured. If the directives of the circular could not be carried out, due to circumstances beyond one's control, the unmatured arrack could be bottled with the prior permission of the Officer-in-charge of the bottling unit of paying certain additional amount therefor.**

G

When the respondent was not able to comply with the directives of the circular, it obtained permission of the appropriate authority for the said purpose on payment of certain additional amount. He also paid some amount for non-fixation of labels on the bottles. Respondent in his income tax return claimed deduction for the said amount from his gross income. Assessing

H

Authority denied the deduction on the grounds that the amount was in the nature of penalty; and that since the same had not been paid during the period relevant to the assessment year, it had to be disallowed in terms of Section 43-B of Income Tax Act, 1961. Appellate Authority allowed the claim of the assessee holding that the amount was neither excise duty nor a penalty and therefore Section 43-B would not be attracted. Tribunal held that the amount was in the nature of additional levy; and that section 43-B was not applicable. High Court held that the amount was not a penalty, neither a fee nor excise duty; payment made for non-fixation of labels was also not a penalty. Hence, the present appeal by Revenue.

Dismissing the appeal, the Court

HELD: 1. Penalty and Excise Duty *vis-a-vis* levies which are made on manufacture of an excisable article stand on different footings. Ordinarily, Excise Duty is a tax on manufacture. The same is in the Union List. An exception, however, is made only in respect of the potable alcohol by reason of Entry 51, List II of the Seventh Schedule of the Constitution of India. Thus, levy of excise duty on alcohol must have a source in a statute legislated in terms of Entry 51, List II of the Seventh Schedule of the Constitution of India. It must have a direct relationship with manufacture of Arrack. By reason of sub-rule (3) of Rule 14 of the Karnataka Excise (Manufacturing and Bottling of Arrack) Rules, 1987, no period of time has been specified. It has been so done under an executive order issued by the Commissioner of Excise. The authority did not and in fact could not levy a tax on manufacture in terms of the said circular or otherwise. As no time limit has been specified by reason of a statute, the question of imposing any penalty for non-compliance of the statutory provisions does not arise. It contemplates an additional levy. Source for such additional levy having regard to the nature of the circular must be found in the terms and conditions of the licence. Such terms and conditions of licence are fixed by the State by reason of the provisions of the Karnataka Excise Act, 1965 made in terms of Entry 8 of List II of the Seventh Schedule of the Constitution of India. Such payments are, therefore, made in pursuance of or in furthermore of the terms of the licence which is referable to Entry 8 and not as a tax on manufacture. A levy is imposed by the State in exercise of its monopoly power. Even such monopoly power of the State is restricted. An excise duty which is in the nature of tax can be imposed only by a statute which answers the description of Article 265 of the Constitution of India.

[Paras 14, 15, 16 and 19] [965-E-H; 966-A-C; 967-C-G]

11 SCC 1, relied on.

Kerala Samsthana Chethu Thozhilali Union v. *State of Kerala and Ors.*, **[2006] 4 SCC 327, referred to.**

2. The time period fixed for blending is not under a statute. 15 days' time is not necessary for the purpose of manufacture of excisable articles. It is a time fixed by the Commissioner. Furthermore, levy is not on manufacture. Blending even otherwise is not prohibited. Public health was not the subject matter of the said circular. It laid down only a process of bottling. It was, thus, issued with a view to regulate the trade. It would, however, not be an additional duty and, therefore, not a tax on manufacture. [Para 17] [967-D-E]

Commissioner of Central Excise v. *M/s. Indian Aluminium Co. Ltd.*, **(2006) 10 SCALE 34, referred to.**

3. Tribunal and the High Court were correct in their views that section 43-B of the Act was no attracted in the case. [Para 18] [967-F]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1813 of 2007.

From the Final Judgment and Order dated 04.12.2003 of the High Court of Karnataka at Bangalore in I.T.A. No. 313 of 2002.

Mohan Parasaran, ASG., Chidananda D.L. and B.V. Balaram Das for the Appellants.

Dhruv Mehta, Harsh Vardhan Jha and Yashraj Singh Deora (for K.L. Mehta & Co.) for the Respondent.

The Judgment of the Court was delivered by

S.B. SINHA, J. 1. Leave granted.

2. Respondent carries on business of arrack bottling, manufacture of industrial alcohol and their marketing. He obtained a licence from the State of Karnataka for the aforementioned purposes in terms of the provisions of Karnataka Excise Act, 1965. Indisputably, the matter relating to manufacture and bottling of arrack is governed by the said Act and the rules framed thereunder by the State of Karnataka known as Karnataka Excise (Manufacturing & Bottling of Arrack) Rules, 1987 (for short "the Rules"). Rule with which we are concerned herein is sub-Rule (3) of Rule 14 which reads

as under:-

"(3) Arrack after blending shall be matured in such manner and for such period as may be specified by the Commissioner from time to time."

3. The Commissioner of Excise, however, issued a circular stating:

"It is hereby specified that the arrack shall be matured in wooden vats for a minimum period of 15 days before bottling the same."

4. A period of 15 days, thus, had been prescribed for the aforementioned purpose. A question, however, arose as to what would happen to the excise article, if for circumstances beyond one's control, said directives cannot be carried. With a view to meet that contingency, it was stated:

"In case the bottling unit for any reason beyond his control is not able to mature the arrack in the manner and to the extent specified above, the unmatured arrack may be bottled with the prior permission of the officer in-charge of the bottling unit. The penalty for supplying unmatured arrack as specified above would be 29 paise per bulk litre."

5. Indisputably, Respondent obtained permission of the appropriate authority in terms thereof as he was not in a position to comply with the first part of the said circular on paying certain additional amount therefor. He, in his income tax return, claimed deduction for the said amount from his gross income.

6. The Assessing Authority was of the opinion that as the amount payable by the assessee was in the nature of penalty, he was not entitled to any deduction. It was further opined that even if the expenditure is deductible, in view of the fact that the amount in question had not been paid during the period relevant to the assessment year, the same had to be disallowed in terms of Section 43B of the Income Tax Act, 1961 (for short "the Act").

7. The Assessee paid certain amounts for not affixation of labels on the bottles. He preferred an appeal against the order of assessment and the Appellate Authority, being the Commissioner of Income Tax (Appeals), allowed the same opining that the amount claimed is neither in the nature of 'excise duty' nor a penalty.

8. In regard to the applicability of Section 43B of the Act, it was held

A that as the amount, in question, is neither penalty nor excise duty, Section 43B of the Act would not be attracted.

9. Appellant preferred an appeal thereagainst before the Income Tax Appellate Tribunal. The Appellate Tribunal opined that the payments made by the respondent were in the nature of an additional levy. In regard to the B applicability of Section 43B of the Act, the Tribunal held it in the negative.

10. An appeal thereagainst preferred by the Revenue under Section 260A of the Act, has been dismissed by the High Court by reason of the impugned judgment. Before the High Court, the following purported questions C of law were framed:

> "(i) Whether the Appellate Tribunal were correct in holding that the amount of Rs. 13,25,572/- levied by the Deputy Commissioner of Excise (Breweries & Distilleries), Bangalore, for failing to affix adhesive labels on arrack bottles and failing to mature the arrack for the D prescribed period as per Karnataka Excise (Manufacturing & Bottling of Arrack) Rules, 1997 was an allowable deduction despite the penalty levied having arisen due to infraction of law?
>
> (ii) Whether the penalty of Rs. 13,25,572 levied by the Deputy Commissioner of Excise (Breweries & Distilleries), Bangalore and not E paid by the assessee during the assessment year could be disallowed u/s 43 of the Act?"

11. Relying upon a decision of the said Court in *Ugar Sugar Works Ltd.* v. *State of Karnataka,* passed in Writ Petition No. 5008 of 1991 disposed of on 5th September, 1991, the High Court held:

F (i) The amount in question was not a penalty;

(ii) It was also not to be treated either as a fee or excise duty.

(iii) The payment made for non-affixation of labels also is not a penalty; stating:

G "10. Therefore, in the absence of labels not being available, if the assessee was made liable to pay the amount to the Department towards the cost of the labels for getting the bottled arrack released, it is not possible to take the view that such payment was made by way of fees as contended by Sri Seshachala. The language employed in the Rule H makes it explicit that the amount required to be paid to get the bottled

arrack released for sale without labels is by way of cost of labels to the Government. When the language in the Rule in explicit terms provide that the amount required to be paid towards the cost of labels and the Rule also impose an obligation on the licensee to get the labels affixed at his cost in the presence of the Warehouse Officer, it will not be correct to consider that the amount paid is not as a cost towards the value of labels, but as a fee. Therefore, the third submission of Sri M.V. Seshachala is also liable to be rejected."

12. Mr. Mohan Parasaran, learned Additional Solicitor General appearing on behalf of the appellants, submitted that the Tribunal and consequently the High Court went wrong in passing the impugned Judgment insofar as they failed to take into consideration that the amount in question having been levied for non-compliance of certain statutory provisions, would amount to penalty and in any event as Section 43B of the Act postulated that the payments in respect whereof deduction are claimed must be the amount actually paid during the assessment year, the impugned orders cannot be sustained.

13. Mr. Dhruv Mehta, learned counsel appearing on behalf of the respondent, however, supported the judgment.

14. Penalty and Excise Duty *vis-a-vis* levies which are made on manufacture of an excisable article stand on different footings. Ordinarily, Excise Duty is a tax on manufacture. The same is in the Union List. An exception, however, is made only in respect of the potable alcohol by reason of Entry 51, List II of the Seventh Schedule of the Constitution of India which reads as under:-

"51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:

(a) alcoholic liquors for human consumption;

(b) opium, Indian hemp and other narcotic drugs and narcotics, but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry."

15. Thus, levy of excise duty on alcohol must have a source in a statute legislated in terms of Entry 51, List II of the Seventh Schedule of the Constitution of India. It must have a direct relationship with manufacture of

A Arrack. By reason of Sub-rule (3) of Rule 14 of the Rules, no period of time has been specified. It has been so done under an executive order issued by the Commissioner of Excise. The Authority did not and in fact could not levy a tax on manufacture in terms of the said circular or otherwise. As no time limit has been specified by reason of a statute, the question of imposing any penalty for non-compliance of the statutory provisions does not arise. It B contemplates an additional levy. Source for such additional levy having regard to the nature of the circular must be found in terms and conditions of the licence. Such terms and conditions of licence are fixed by the State by reason of the provisions of the Act made in terms of Entry 8 of List II of the Seventh Schedule of the Constitution of India. Such payments are, therefore, C made in pursuance of or in furtherance of the terms of the licence which is referable to Entry 8 and not as a tax on manufacture. This aspect of the matter has been considered by a Constitution Bench of this Court in *State of Kerala and Ors.* v. *Maharashtra Distilleries Ltd. and Ors.*, [2005] 11 SCC 1 stating:

> "79. In this connection we may usefully refer to the decision of this D Court in *State of Punjab* v. *Devans Modern Breweries Ltd.* In that case the State of Kerala was also a party. The State had imposed tax on import of potable liquor manufactured in other States. The stand of the State was that it was within the province of the State to impose restriction on import of potable liquor by imposing import duty. The aforesaid duty had not been imposed by the State in exercise of its E statutory power conferred upon it in terms of Entry 51 List II of the Seventh Schedule to the Constitution but regulatory power as envisaged in Entry 8 thereof. The contention raised on behalf of the respondents was that the requirements of Articles 301 and 304 of the Constitution were to be complied with in view of the fact that the duty F of import must conform to the provisions of Entry 51 of List II. The submission of the respondents was rejected and those advanced on behalf of the State of Kerala were accepted. This Court observed that the word fee is not used in the strict sense to attract the doctrine of quid pro quo. This was the price or consideration which the State Government had charged for parting with its privilege and granting G the same to the vendors. Therefore, the amount charged was neither a fee nor a tax but was in the nature of price of a privilege which the purchaser had to pay in any trading and business in noxious article/ goods. This Court held that the permissive privilege to deal in liquor is not a right at all. The levy charged for parting with its privilege is H neither a tax nor a fee. It is simply a levy for the act of granting

permission or for the exercise of power to part with that privilege. This Court referred to numerous decisions of this Court which have clearly held that the State has a right to exercise all forms of control in relation to all aspects regarding potable alcohol and the State Legislature has exclusive competence to frame laws in that regard. The State has exclusive right in relation to potable liquor and there was no fundamental right to do trade or business in intoxicants. The State in its regulatory power has the right to prohibit absolutely every form or activity in relation to intoxicants its manufacture, storage, export, import, sale and possession and all these rights are vested in the State and indeed without such vesting there can be no effective regulation of various forms of activities in relation to intoxicants." A B C

16. A levy is imposed by the State in exercise of its monopoly power. Even such monopoly power of the State is restricted. [See *Kerala Samsthana Chethu Thozhilali Union* v. *State of Kerala and Ors.*, [2006] 4 SCC 327]

17. There is another aspect of the matter. The time period fixed for blending is not under a statute. 15 days' time is not necessary for the purpose of manufacture of excisable articles. It is a time fixed by the Commissioner. Furthermore, levy is not on manufacture. Blending even otherwise is not prohibited. No time limit was fixed under the statute. Public health was not the subject matter of the said Circular. It laid down only a process of bottling. It was, thus, issued with a view to regulate the trade. It would, however, not be an additional duty and, therefore, not a tax on manufacture. What would be a tax on manufacture has recently been considered in *Commnr. Of Central Excise* v. *M/s. Indian Aluminium Co. Ltd.*, (2006) 10 SCALE 34. D E

18. We, therefore, are of the opinion that the Tribunal and the High Court were correct in their views that Section 43B of the Act was not attracted in the case. F

19. An excise duty which is in the nature of tax can be imposed only by a statute which answers the description of Article 265 of the Constitution of India. G

20. We, therefore, are of the opinion that the Tribunal and the High Court have not committed any error in passing the impugned judgment. The appeal is dismissed with costs. Counsel's fee assessed at Rs. 25,000/-.

K.K.T. Appeal dismissed. H