

Vam Organic Chemicals Ltd. and Another

Vs

State of U. P. and Others

India Glycols Limited and Another

Vs

State of U. P. and Others

Civil Appeals Nos. 230 and 231 of 1997

(CJI A. M. Ahmadi, S. C. Sen JJ)

21.01.1997

JUDGMENT

AHMADI, C.J. -

1. Leave granted.

2. These two appeals are filed against the judgment of the High Court of Allahabad dated 9-9-1991 whereby the writ petitions filed by the appellants herein challenging the Notification No. 25/Licence/Part 3 dated 18-5-1990 issued by the Excise Commissioner, Uttar Pradesh, were dismissed. The impugned Notification dated 18-5-1990 was issued in exercise of powers conferred by Section 41 of the U.P. Excise Act, 1910 (hereinafter called "the Act") with the prior approval of the State Government. By the said notification certain amendments were made in the Rules published with Notification No. 423-Five/284/B, dated 26-9-1910. Section 41 of the Act gives power to the Excise Commissioner to make Rules, inter alia, for regulating the manufacture, supply, storage or sale of any intoxicant; for regulating deposit and removal of any intoxicant and prescribing the scale of fees or manner of fixing the fees payable for licence, permit or pass, including for the grant of any exclusive or other privilege under Sections 24 and 24-A of the said Act. The earlier Rule 2 was substituted by a new Rule 2 entitled "Denaturation of Spirit". The amended rule provides for a new licence for denaturation of spirit in a prescribed form to be issued by the Collector to all distilleries situated within his district holding licence PD-1 or PD-2 and persons holding licences FL-16, FL-39, FL-40 and FL-41 to denature the spirit. It further prescribed that the distilleries mentioned above and holding licence for denaturation of spirit shall be liable to pay a denaturation fee at the rate of 7 paise per litre in advance. The appellants Vam Organic Chemicals Limited are manufacturing vinyl acetate monomer, a basic organic chemical for which industrial alcohol is the main feed stock. The industrial alcohol is being produced in the distillery of the appellants and according to the appellants the entire industrial alcohol produced is denatured as per the method approved by the State Excise Authorities and is being used in their factory for manufacturing vinyl acetate monomer. The other appellants, viz., India Glycols Limited and another, are manufacturing Monoethylene Glycol and its products Diethylene glycol and heavy glycol. One part of the factory of the these appellants is being used for manufacturing ethyl alcohol produced by them for being captively consumed.

3. The appellants hold licences in the form of FL-39 to enable them to use the industrial alcohol as the main raw material for their product. They were obliged to take out licence in the form of DS-1 as prescribed in the impugned notification and pay a licence fee at the rate of 7 paise per litre with effect from 2-6-1990. The notification is challenged on two grounds, namely, that the State of Uttar Pradesh has no power to legislate in respect of industrial alcohol or to levy taxes in respect thereof and further that the levy being not based on quid pro quo was otherwise bad. The State of Uttar Pradesh contested the writ petitions. By the impugned judgment, the High Court rejected all the contentions of the appellants and dismissed the writ petitions. Hence these appeals by special leave.

4. Before proceeding further, it will be proper to understand the difference between industrial alcohol, denatured spirit and potable liquor. Ethyl alcohol is rectified spirit of 95% v/v in strength. Rectified spirit is highly toxic and unfit for human consumption. However, rectified spirit diluted with water is country liquor. Rectified spirit, as it is, can be used for manufacture of various other products like chemicals etc. Rectified spirit, produced for industrial use is required by a notification issued under the Act to be denatured in order to prevent the spirit from being directed to human consumption. Rectified spirit is denatured by adding denaturants which make the spirit unpalatable and nauseating. As such rectified spirit can be converted to potable liquor but once denatured it can be used only as industrial alcohol. The process of denaturation described by the respondent is narrated by the High Court in the following words :

"Denaturation of rectified spirit is a highly technical process. Every drum/lot/batch has to be tested by the Chief Development Officer at the Excise Headquarters' Laboratory so as to ensure that the same is according to the prescribed specification before they are allowed to be used for denaturing the rectified spirit. After they are properly tested, the denaturants have to be separately stored under lock and key of the officer-in-charge of the distillery, and measured quantities are pumped into denaturation vats at the time of denaturation. The process of mixing goes on for several hours. The resultant mixture is denatured spirit or specially denatured spirit, as the case may be. After denaturing, it is again tested to find out whether it has been properly denatured or not. The Excise Department is obliged to, and does maintain a laboratory for this purpose at the Headquarters of the Excise Commissioner. There is a Chief Development Officer, assisted by four Assistant Alcohol Technologists and a large number of supporting staff apart from apparatus and other equipment. Denaturation takes place under the close supervision of the Excise Officials in accordance with the provisions of Rule 785 of the U.P. Excise Manual, Volume I."

5. The first contention raised before the High Court was that rectified spirit being industrial alcohol as held by the Supreme Court in *Synthetics and Chemicals Ltd. v. State of U.P.* [(1990) 1 SCC 109 : 1989 Supp (1) SCR 623] and being not fit for human consumption, the State Legislature has no power to make a law with respect to it or to charge licence fee or levy any other impost. It was submitted by the petitioners that industrial alcohol is within the exclusive domain of Parliament by virtue of declaration made by it in Section 2 of the Industries Development and Regulations Act, 1956 (hereinafter referred to as "the IDR Act") and the addition of Item 26 in the Schedule to the Act. Further, it was submitted that Entry 8 or Entry 51 of List II of the Seventh Schedule to the Constitution cannot support the impugned notification. Entry 33 of List III, the petitioners submitted, could not sustain it as the field was occupied by the provisions of Section 18-G of the IDR Act.

6. So far as List II is concerned, the impugned judgment refers to Entries 6, 8, 24, 51 and 66 to

conclude that the notification is covered by Entries 6 and 8. The said entries are reproduced below :

"6. Public health and sanitation; hospitals and dispensaries.

8. Intoxicating liquors, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors.

24. Industries subject to the provisions of Entries 7 [Industries declared by Parliament by law to be necessary for the purpose of defence or for the prosecution of war] and 52 [Quoted in the following page] of List I.

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.

66. Fees in respect of any of the matters in this List, but not including fees taken in any court."

Production, possession, storage, and distribution of country liquor, IMFLs, wines etc. are fully controlled by the State. (See Section 24-B, U.P. Excise Act.) The U.P. Excise Act and Rules made thereunder prescribe a system of licensing for producing rectified spirit, for obtaining country liquor, etc., as well as for possession, storage and trade in these products. The licensing has the twin objective, the High Court points out, of raising revenue and regulating trade in the noxious goods. The High Court finds the Entries 6 and 8 of List II as providing the field for legislation and consequent licensing for denaturation of spirit and Entry 51 as providing the scope for levy of duties.

7. Coming to List III, the relevant entry is 33 :

"33. Trade and commerce in, and the production, supply and distribution of, -

(a) the products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest, and imported goods of the same kind as such products;

(b) foodstuffs, including edible oilseeds and oils;

(c) cattle fodder, including oilcakes and other concentrates;

(d) raw cotton, whether ginned or unginned, and cotton seed; and

(e) raw jute."

A similar entry is Entry 52 in List I :

"52. Industries, the control of which by the Union is declared by Parliament by law to be expedient in the public interest."

A declaration is made by Section 2 of the IDR Act that "it is expedient in the public interest that the Union should take under its control the industries specified in the First Schedule".

8. Item 26 of the First Schedule reads :

"26. Fermentation Industries

1. Alcohol

2. Other products of fermentation industries."

Recall Entry 24 of List II :

"24. Industries subject to the provisions of (Entries 7 and 52) of List I."

The impugned judgment now proceeds to examine how much of the field is occupied by the IDR Act so that the area available to the State Legislature can be ascertained.

9. Section 18-G empowers the Central Government to provide for regulating the supply and distribution and trade and commerce in any article or class of articles relatable to any scheduled industry insofar as it appears to it to be necessary or expedient for securing the equitable distribution and availability at fair price. Sub-section (2) specifies the various provisions that can be made under sub-section (1) :

"18-G. Power to control supply, distribution, price, etc., of certain articles. - (1) The Central Government, so far as it appears to it to be necessary or expedient for securing the equitable distribution and availability at fair prices of any article or class of articles relatable to any scheduled industry, may, notwithstanding anything contained in any other provision of this Act, by notified order, provide for regulating the supply and distribution thereof and trade and commerce therein.

(2) Without prejudice to the generality of the powers conferred by sub-section (1), a notified order made thereunder may provide -

(a) for controlling the prices at which any such article or class thereof may be bought or sold;

(b) for regulating by licences, permits, or otherwise the distribution, transport disposal, acquisition, possession, use or consumption of any such article or class thereof;

(c) for prohibiting the withholding from sale of any such article or class thereof ordinarily kept for sale;

(d) for requiring any person manufacturing, producing or holding in stock any such article or class thereof to sell the whole or a part of the articles so manufactured or produced during a specified period or to sell the whole or a part of the articles so

held in stock to such person or class of persons and in such circumstances as may be specified in the order;

(e) for regulating or prohibiting any class of commercial or financial transactions relating to such article or class thereof which in the opinion of the authority making the order are, or if unregulated, are likely to be, detrimental to public interest;

(f) for requiring persons engaged in the distribution and trade and commerce in any such article or class thereof to mark the articles exposed or intended for sale with the sale price or to exhibit at some easily accessible place on the premises the price-lists of articles held for sale and also to similarly exhibit on the first day of every month, or at such other time as may be prescribed, a statement of the total quantities of any such articles in stock;

(g) for collecting any information or statistics with a view to regulating or prohibiting any of the aforesaid matters; and

(h) for any incidental or supplementary matters, including, in particular, the grant of issue of licences, permits or other documents and charging of fees therefor."

Thus, the power under Section 18-G can be exercised only so far as is permitted by sub-section (1) viz. for securing the equitable distribution and availability at a fair price of any article or class of articles relatable to any scheduled industry. To this extent the State Legislature cannot make any law. The High Court concludes that in other respects the field is still open to the State Legislature. The High Court goes on to say that the impugned notification is issued to ensure that rectified spirit sought to be used for industrial purposes is not diverted for obtaining country liquor or other forms of potable liquor and that it is not concerned with equitable distribution and availability at a fair price of either rectified spirit or the denatured spirit. The notification was, thus, justified under Entry 6 of List II - Public Health; and Entry 8 of List II - Possession and sale of intoxicating liquors.

10. This Court dealt with the question of legislative competence of the State to impose tax or levy on industrial alcohol in the case of Synthetics and Chemicals Ltd. v. State of U.P. [(1990) 1 SCC 109 : 1989 Supp (1) SCR 623] and ruled in the negative. The High Court took the view that the distinction between ethyl alcohol/rectified spirit as such and denatured spirit was not in issue, nor was it considered in that judgment and held that this Court cannot be said to have ruled that every rectified spirit/ethyl alcohol is industrial alcohol. The High Court reiterated that once denatured, the alcohol becomes exclusively industrial alcohol since it cannot be used for obtaining country liquor or for manufacturing IMFLs and said that it is to ensure that ethyl alcohol meant for industrial use is not misused or diverted for human consumption that impugned regulation is provided for by the State and further that the regulation being part of general regulation of the trade in alcohol in the interest of public health is relatable to Entries 6 and 8 of List II.

11. The second part of the case relates to the question of quid pro quo between the services rendered by the State and the rate of fee charged. According to the petitioners/appellants, the fee charged was excessive and hence bad. The High Court pointed to the distinction between the regulatory fee and compensatory fee. It opined that the licence fee imposed for regulatory purposes may not carry with it any service rendered, but that such licence fee must be reasonable. Further, the High Court said, it would be appropriate to look to the expenditure which the State incurs for administering the regulation and if there is a broad correlation between the expenditure which the State incurs and the

fees charged, the fees could be sustained as reasonable. It also referred to the counter-affidavit of the State to conclude that a good number of officers and employees are engaged in managing the laboratories besides the staff which is posted at the distilleries and so the rate of 7 paise per litre was in order.

12. In these appeals the appellants reiterate that this Court by its seven-Judge Bench decisions in *Synthetics Chemicals* [(1990) 1 SCC 109 : 1989 Supp (1) SCR 623] has expressly ruled against legislative competence of the State so far as ethyl alcohol/rectified spirit is concerned. Further, they say that even if the State is left with regulatory power to prevent misuse of industrial alcohol for potable purposes, such power did not include power to levy any impost. Further, the appellants say that denaturation is a statutory duty imposed by a notification under the U.P. Excise Act and no service by the State being provided for the same, no fee could be charged and in any case even if the State has to incur any expenses for enforcement of the requirement of denaturation, there is no *quid pro quo* between the expenses incurred and the fees charged.

13. We may note that the term "industrial alcohol" is not used in any of the Lists in the Seventh Schedule of the Constitution. All the entries quoted in the earlier part of the judgment have to be read with Article 248 of the Constitution which specifies residuary powers of the Union :

"248. Residuary powers of legislation. - (1) Parliament has exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or State List.

(2) Such power shall include the power of making any law imposing a tax not mentioned in either of those Lists."

This is reflected in Entry 97 of List I :

"97. Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists."

Whether alcoholic liquors other than "alcoholic liquors for human consumption" or "intoxicating liquor" was a State subject or a Union subject should be the real controversy. It is with a view to describing this kind of liquor that the term "industrial alcohol" is used. After an analysis of all the provisions of law giving the Union Parliament and the State Legislature jurisdiction to legislate on alcohol, this Court in the *Synthetics Chemicals* case [(1990) 1 SCC 109 : 1989 Supp (1) SCR 623] held that the impugned notifications imposing certain fees as vend fee or transport fee etc. were held to be within the legislative competence of the State. A careful reading of that judgment shows that the Court was fully aware of the fact that rectified spirit was the ingredient for intoxicating liquor or alcoholic liquor for human consumption although rectified spirit/ethyl alcohol as well as denatured spirit are referred to as "industrial alcohol" in that judgment. This Court did not hold that the State will have no power whatsoever in relation to "industrial alcohol". In fact, in the judgment itself, the Court has enumerated the various areas relating to industrial alcohol in which the State could still legislate or make rules. The following part of the judgment can be read with profit : (SCR pp. 681-82 : SCC p. 158, para 86)

"The position with regard to the control of alcohol industry has undergone material and significant change after the amendment of 1956 to the IDR Act. After the amendment, the State is left with only the following powers to legislate in respect of

alcohol :

(a) It may pass any legislation in the nature of prohibition of potable liquor referable to Entry 6 of List II and regulating powers.

(b) It may lay down regulations to ensure that non-potable alcohol is not diverted and misused as a substitute for potable alcohol.

(c) The State may charge excise duty on potable alcohol and sales tax under Entry 52 of List II. However, sales tax cannot be charged on industrial alcohol in the present case, because under the Ethyl Alcohol (Price Control) Orders, sales tax cannot be charged by the State on industrial alcohol.

(d) However, in case State is rendering any service, as distinct from its claim of so-called grant of privilege, it may charge fees based on quid pro quo. See in this connection, the observations of Indian Mica case [Indian Mica Micanite Industries v. State of Bihar, (1971) 2 SCC 236]."

Denaturation of spirit meant for industrial use is meant to prevent misuse of non-potable alcohol for human consumption and as such specifically mentioned by the Court to be within the legislative competence of the State.

14. It is to be noticed that the States under Entries 8 and 51 of List II read with Entry 84 of List I have exclusive privilege to legislate on intoxicating liquor or alcoholic liquor for human consumption. Hence, so long as any alcoholic preparation can be diverted to human consumption, the States shall have the power to legislate as also to impose taxes etc. In this view, denaturation of spirit is not only an obligation on the States but also within the competence of the States to enforce.

15. This Court had occasion to deal with the same entries in the three lists and their effect when confronted with the IDR Act in the case of Shri Bileshwar Khand Udyog Khedut Sahakari Mandali Ltd. v. State of Gujarat [(1992) 2 SCC 42 : (1992) 1 SCR 391]. In that case, the matter under challenge was the validity of demand under Section 58-A of the Bombay Prohibition Act for maintenance of the excise staff for supervision of the manufacture of industrial alcohol which was assailed for lack of legislative competence of the State. The appellant in that case urged that even if the State's power to supervise production of alcohol is conceded, the State could not be said to have the power to impose any levy to meet the cost of supervision. The Court observed : (SCC pp. 44-45, para 4)

"According to learned counsel since the entire judgment of the High Court proceeded on privilege theory it cannot withstand the principle laid down in Synthetics and Chemicals case [(1990) 1 SCC 109 : 1989 Supp (1) SCR 623]. Levy as a fee under Entry 8 of List II of Seventh Schedule or excise duty under Entry 51 are different than cost of supervision charged under Section 58-A. The former has to stand the test of a levy being in accordance with law on power derived from one of the constitutional entries. Since Synthetics and Chemicals case [(1990) 1 SCC 109 : 1989 Supp (1) SCR 623] finally brought down the curtain in respect of industrial alcohol by taking it out of the purview of either Entry 8 or 51 of List II of Seventh Schedule the competency of the State to frame any legislation to levy any tax or duty is excluded. But by that a provision enacted by the State for supervision which is

squarely covered under Entry 31 of the Concurrent List which deals with production, supply and distribution which includes regulation cannot be assailed. The Bench in Synthetics and Chemicals case [(1990) 1 SCC 109 : 1989 Supp (1) SCR 623] made it clear that even though the power to levy tax or duty on industrial alcohol vested in the Central Government the State was still left with power to lay down regulations to ensure that non-potable alcohol, that is, industrial alcohol, was not diverted and misused as substitute for potable alcohol. This is enough to justify a provision like Section 58-A. In paragraph 88 of the decision it was observed that in respect of industrial alcohol the States were not authorised to impose the impost as they have purported to do in that case but that did not effect any imposition of fee where there were circumstances to establish that there was quid pro quo for the fee nor it will affect any regulatory measure. This completely demolishes the argument on behalf of appellant."

The judgment was followed in a later case raising the same questions and challenging the validity of Section 58-A of the Bombay Prohibition Act, namely, Gujchem Distillers India Ltd. v. State of Gujarat [(1992) 2 SCC 399 : (1992) 1 SCR 675]. On a proper appreciation of the legal situation, the fee of 7 paise per litre has to be seen as a part of the regulatory measure, namely, denaturation of spirit and supervision of the said process.

16. More recently the effect of interaction of Entries 8 and 24 in List II, Entry 52 of List I of the Seventh Schedule and Entry 26 of the First Schedule of the IDR Act came to be considered in the case of State of A.P. v. McDowell & Co. [(1996) 3 SCC 709 : JT (1996) 3 SC 679]. The State of Andhra Pradesh prohibited the manufacture of liquor by an amendment in the Andhra Pradesh Prohibition Act, 1995. "Liquor" in the Act was defined as under:

"(7) 'Liquor' includes, -

(a) spirit of wine, wine, beer and every liquid consisting of or containing alcohol including Indian liquor and Foreign liquor,

(b) any other intoxicating substance which the Government may by notification, declare to be liquor for the purposes of this Act,

but does not include toddy, denatured spirits, methylated spirits and rectified spirits;"

We may also notice Section 7-A. By that section manufacture of liquor came to be prohibited.

17. M/s. McDowell & Co., manufacturers of intoxicating liquors challenged the constitutional validity of the Act by which the Prohibition Act was amended to include Section 7-A. One of the grounds of challenge was lack of legislative competence in view of Entry 26 in the First Schedule of the IDR Act which according to the writ petitioners, vested the control of alcohol industries exclusively in the Union and denuded the State Legislature of its power to licence or regulate the manufacture of liquor. This submission was based on the fact that fermentation industries were included in the Schedule of the IDR Act and hence the State was denuded of its power to licence and regulate manufacture of liquor. Entry 26 reads "Fermentation Industries, (1) Alcohol, (2) other products of fermentation industries". It was argued that after the amendment the control and regulation of such industries and their product fell within the exclusive province of the Union and hence the State lost its competence to grant, refuse or renew the licences. After an analysis of all the

relevant provisions of the law the Court concluded as under :

"(W)e must first carve out the respective fields of Entry 24 and Entry 8 in List II. Entry 24 is a general entry relating to industries whereas Entry 8 is a specific and special entry relating inter alia to industries engaged in production and manufacture of intoxicating liquors. Applying the well-known rule of interpretation applicable to such a situation (special excludes the general), we must hold that the industries engaged in production and manufacture of intoxicating liquors do not fall within Entry 24 but do fall within Entry 8. This was the position at the commencement of the Constitution and this is the position today as well. Once this is so, the making of a declaration by Parliament as contemplated by Entry 52 of List I does not have the effect of transferring or transplanting, as it may be called, the industries engaged in Production and manufacture of intoxicating liquors from the State List to Union List. As a matter of fact, Parliament cannot take over the control of industries engaged in the production and manufacture of intoxicating liquors by making a declaration under Entry 52 of List I, since the said entry governs only Entry 24 in List II but not Entry 8 in List II."

It was reiterated in the later part of the judgment as under :

"It follows from the above discussion that the power to make a law with respect to manufacture and production and its prohibition (among other matters mentioned in Entry 8 in List II) belongs exclusively to the State Legislatures. Item 26 in the First Schedule to the IDR Act must be read subject to Entry 8 - and for that matter, Entry 6 - in List II. So read, the said item does not and cannot deal with manufacture, production of intoxicating liquors. All the petitioners before us are engaged in the manufacture of intoxicating liquors. The State Legislature is, therefore, perfectly competent to make a law prohibiting their manufacture and production - in addition to their sale, consumption, possession and transport - with reference to Entries 8 and 6 in List II of the Seventh Schedule to the Constitution read with Article 47 thereof."

18. The High Court in the impugned judgment has drawn a distinction between fees charged for licences, i.e., regulatory fees and the fees for services rendered as compensatory fees. The distinction pointed out by the High Court can be seen in clause (2) of Article 110 :

"110. (2) A Bill shall not be deemed to be a Money Bill by reason only that it provides for the imposition of fines or other pecuniary penalties, or for the demand or payment of fees for licences or fees for services rendered, or by reason that it provides for the imposition, abolition, remission, alteration or regulation of any tax by any local authority or body for local purposes."

The High Court has quoted from this Court's decision in *Corpn. of Calcutta v. Liberty Cinema* [AIR 1965 SC 1107 : (1965) 2 SCR 477] which was based on a Privy Council judgment in *George Walkem Shannon v. Lower Mainland Dairy Products Board* [1938 AC 708 : AIR 1939 PC 36]. This Court said in the *Corpn. of Calcutta v. Liberty Cinema* [AIR 1965 SC 1107 : (1965) 2 SCR 477].

"In fact, in our Constitution fee for licence and fee for services rendered are contemplated as different kinds of levy. The former is not intended to be a fee for services rendered. This is apparent from a consideration of Article 110(2) and Article

199(2) where both the expressions are used indicating thereby that they are not the same."

The High Court has taken the view that in the case of regulatory fees, like the licence fees, existence of quid pro quo is not necessary although the fee imposed must not be, in the circumstances of the case, excessive. The High Court further held that keeping in view the quantum and nature of the work involved in supervising the process of denaturation and the consequent expenses incurred by the State, the fee of 7 paise per litre was reasonable and proper. We see no reason to differ with this view of the High Court.

19. In view of the foregoing, the appeals are dismissed. No costs.