State Of U.P. And Ors vs Vam Organic Chemicals Ltd. And Ors on 17 October, 2003

Equivalent citations: AIR 2003 SUPREME COURT 4650, 2004 (1) SCC 225, 2003 AIR SCW 5463, 2003 ALL. L. J. 2700, 2004 (2) SRJ 125, (2004) 15 ALLINDCAS 155 (SC), (2003) 8 JT 1 (SC), (2003) 12 INDLD 165, (2003) 8 SCALE 775, (2003) 8 SUPREME 165

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Bench: Ruma Pal, B.N. Srikrishna

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           CASE NO.:
Appeal (civil)  5416-5424 of 2000

PETITIONER:
STATE OF U.P. AND ORS.

RESPONDENT:
VAM ORGANIC CHEMICALS LTD. AND ORS.

DATE OF JUDGMENT: 17/10/2003

BENCH:
RUMA PAL & B.N. SRIKRISHNA

JUDGMENT:
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JUDGMENT 2003 Supp(4) SCR 957 The Judgment of the Court was delivered by RUMA PAL, J. : Leave granted in the special leave petition.

A series of writ petitions were filed by the respondents in the Allahabad High Court challenging a notification dated 13th January 1990 whereby licence fee of 15 paise per litre was sought to be imposed on the quantity of specially denatured spirit (SDS) obtained from distilleries in Uttar Pradesh under Rule 3(a) of the U.P. Licences for the Possession of Denatured Spirit and Specially Denatured Spirit Rules, 1976. All the writ petitions were allowed by the High Court. The State has questioned the correctness of the decision in these appeals.

The basic facts in all these appeals are substantially similar. Therefore, the facts in the case of Vam Organic Chemicals Ltd. and Anr. are taken as illustrative for the purpose of our decision.

The respondent - company manufactures organic chemicals such as Acetic Acid, Acetic Anhydride and vinyl Acetate at its chemical plant. The main raw material for manufacture of these organic chemicals is Ethyl alcohol (industrial grade) which in turn is produced from molasses. In 1982, the respondent set up its own distillery for producing the industrial alcohol. The distillery is registered

under the provisions of the Industries (Development and Regulation) Act, 1951. The entire production of industrial alcohol at the respondents' distillery as well as industrial alcohol from outside sources is used at its chemical plant for producing the organic chemicals mentioned earlier. The entire quantity of industrial alcohol is "denatured" before it leaves the respondents distillery and carried in pipes to the chemical plant. It is this denatured industrial alcohol which is subjected to the disputed levy.

The levy of the disputed licence fee is legislatively traceable to the UP Excise Act, 1910. This Act provides for the control of and levy of excise duty on intoxicating liquor and on intoxicating drugs in the State of Uttar Pradesh. The word "intoxicant" has been defined under Section 3(13) of the Act as meaning 'any liquor or intoxicating drug'. Liquor has in turn been defined in Section 3(11) as meaning 'intoxicating liquor and includes spirits of wine, spirit wine, tari, pachwai, beer and all liquid consisting of or containing alcohol, also any substance which the State Government may by notification declare to be liquor for the purposes of this Act'.

Industrial alcohol with which we are now concerned is not liquor nor is it potable as such. However, it may be utilised to produce a kind of liquor if it is 'denatured' 'Denatured' according to the definition of the word in section 3(9) of the Act means :

> "rendered unfit for human consumption in such manner as may be prescribed by the State Government by notification in this behalf."

The denaturants and their specification and the manner of denaturation have been prescribed by the State Government. Separate premises previously approved for the purpose by the Excise Commissioner are required to be provided for the process of denaturation and for the storage of denaturing agents and the vessels and receptacles used in the process. Denaturation must take place in these premises only and issue and storage of denatured spirit can only be made from or in these premises. The premises are to be secured by an excise lock, and denaturation is to take place under the direct supervision of the officer-in-charge. (see para 784 of the U.P. Excise Manual). After the denaturation the emerging product is to be further tested in the manner specified by the Excise authorities. If the alcohol has not been satisfactorily denatured it is to be destroyed (vide paragraph 785 ibid). It is not in dispute that the respondent has followed all these regulatory measures.

To ensure the denaturation of industrial alcohol, in exercise of the powers under Section 41 of the 1910 Act, the Uttar Pradesh Licences for the Possession of Denatured Spirit and Specially Denatured Spirit Rules, 1976 (hereafter referred to as 'the Rules') were made. Rule 2 initially only provided for the three types of licences which are required for the possession of denatured spirit including specially denatured spirit for industrial purposes, namely, licences in form FL-39, FL-40 and FL-41. The respondents herein are all holders of lilcences in Form FL-39 which is granted for the possession of denatured spirit for use in industries in which the alcohol is destroyed or converted chemically in the process into any other product and the product does not contain alcohol such as Either, Styrene, Butadiene, Acetone Polythene etc. The fee for licences in form FL-39 is imposable under Rule 3(a) which initially read :

"3(a) The fee for a licence in Form F.L. 39 shall be at a rate prescribed for industry to industry by the Excise Commissioner per litre, payable on the quantity of specially denatured spirit obtained from any distillery in Uttar Pradesh. The fee shall be realised by the Excise Inspector Incharge of the Distillery from the licensee before making issues of the specially denatured spirit from the distillery and shall be deposited in the Treasury under the Head "X-State Excise Miscellaneous Confiscation and Miscellaneous

(a) Contribution towards Establishment."

In 1979 by notification No. 951/Licence-3, dated 31st May, 1979 Rule 3(a) was amended and the fee for licence in form FL-39 was fixed for the first time at a rate of 10 paise per litre of specially denatured spirit (SDS). It was made clear that "the fee shall be realised by the Excise Inspector in charge of the distillery from the licensee before making issues of the specially denatured spirit from the distillery and shall be deposited in the Treasury under the head 039. State Excise-E-Commercial and Denatured Spirit medicated wines-B-licence fees commercial spirits". The rate of fee has been subsequently revised on 13th January 1990 to 15 paise per litre.

During this period, on 25th October, 1989 a 7-Judge Bench decision in Synthetics and Chemicals Ltd. v. State of U.P., [1990] 1 SCC 109 : [1989] Supp 1 SCR 623 held that the State was not legislatively competent to levy taxes on industrial alcohol. The subject matter of challenge in Synthetics was the imposition of various levies by the State legislatures on industrial alcohol. In the lead case of Synthetics (WP 182/1980) a particular challenge was made to a Notification issued by the Government of UP in 1979 in exercise of powers under S. 40, sub-section (1) read with sub section (2)(d) of UP Excise Act amending the Rule for levying vend fee on industrial alcohol.

Synthetics and Chemicals Ltd. also filed a second writ petition (WP No. 2423 of 1980) in this Court challenging the imposition of licence fee of 10 paise per litre under Rule 3(a) by the notification dated 31st May, 1979 referred to earlier and asked for refund of the payments which the State had been recovering from Synthetics and Chemicals Ltd. since 17th May, 1979 and which the company had been paying under protest. By order dated 21st July, 1980 WP 2423/80 was tagged along with WP 182/ 1980. The Order also said that if Synthetics and Chemicals succeeded in W.P. No. 2423 of 1980 then the State would refund the amounts which formed the subject matter of the writ petition. As already noted the challenge of the industries to the State levy of tax on industrial alcohol succeeded before the Constitution Bench.

Synthetics & Chemicals Ltd. then filed an application in WP No. 2423 of 1980 in which it contended that the Constitution Bench had disposed of both its writ petitions viz., WP 182/1980 and 2423/1980 by its judgment striking down the provisions of the Act and Rules which sought to levy tax on industrial alcohol. As such a prayer was made inter alia for refund of the amounts paid on account of licence fee levied under Rule 3(a) together with interest at 9% p.a. By an order dated 6.5.91 the application was allowed by this Court. However, since the Constitution Bench decision was to operate prospectively it was directed that while Synthetic & Chemicals Ltd. would not be entitled to any refund for the amounts already paid to the State "there would be no liability

prospectively from the date of judgment and the demand by the State of Uttar Pradesh would not be levied thereafter". The State filed an application for modification and clarification of this Order on the ground that only the vend fee on industrial alcohol had been struck down by the Constitution Bench and vend fee was entirely different from the licence fee which was imposed on FL-39 licensees. The State's plea was that "the order dated 6.5.1991 is being treated as a precedent and the levies of licence fees to regulate issue of alcohol for industrial purposes are being challenged in the High Court and the stay order are being issued by the Hon'ble High Court of Allahabad on the basis of the aforesaid order of 6.5.1991". While dismissing the State's application on 25.4.1994, this Court said :

> "Mr. D.V. Sehgal, learned senior advocate appearing for the respondent State, states that licence fee has been challenged by various parties in the High Court. The State of Uttar Pradesh can raise all the points available to it before the High Court".

Soon thereafter on 22.6.1999 the following circular was issued by the Excise Commissioner to all District Magistrates in the State :

> "In compliance with the judgment dated 25,10.89 passed by the Hon'ble Supreme Court in W.P. (C) No. 182/81, Synthetic & Chemicals Ltd v. State of U.P. & Ors., the recovery of the vend fees from license holders by the Industrial Units, FL-39, FL-40, FL-41 and FL-16 has been declared illegal with prospective effect. In addition the Hon'ble High Court by its judgment dated 12.7.90 in WP No. 36/76, Synthetic & Chemicals Ltd v. State of U.P. has held diesel Oil and Alcohol Taxation (Amendment) Act, 1976 as illegal. Therefore, in order to ensure the compliance of the above orders this coffice by its circular No. 395/408/9-89-90/ Vam dated 10.4.90 has invited the attention for the non recovery of purchase tax FL-39, 40, 41 and FL-16 from the license holders.
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> In another order passed in W.P.(c) No. 2423/1980 - Synthetic & Chemicals Ltd v. State of U.P. & Ors. on the L.A. No. 1 of the petitioners, the Hon'ble Supreme Court by its order dated 6.5.91, the recovery of licence fee from the Petitioner has been declared illegal with prospective effect. Therefore, after the said order licence fee cannot be recovered from Synthetic & Chemicals Ltd. Bareilly.
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> The compliance of action in accordance with the above may kindly be ensured".

(Emphasis added) Consequently no licence fee is levied on Synthetics and Chemicals Ltd. under Rule 3(a). These facts have been relied on by the respondent to urge that they too cannot be asked to pay any licence fee under Rule 3(a). But before considering their plea one further fact needs to be noted.

On 18th May 1990 a notification was issued by the State of U.P. by which Rule 2 was amended to provide for the taking out of a licence in form DS-1 which was to be issued by the Collector to all distilleries within his district (holding licence in Form PD-1 or PD-2) "for denaturation of spirit for

supply to persons in Form FL-16, FL-39, FL-40 and FL-41" A licence fee in respect of a licence in Form DS-1 was payable in advance @ 7 paise per litre of spirit so denatured by the distillery.

The notification dated 18th May 1990 amending rule 2 was challenged by distilleries, including the respondent, under Article 226 before the High Court. The challenge was on the ground, that the State had no power to legislate in respect of industrial alcohol or to levy tax in respect thereof and that the levy not being based on quid pro quo was otherwise bad. The High Court dismissed the distillers' writ petitions. The appeals from the decision of the High Court were also disallowed by this Court in Vam Organic Chemicals Ltd. and Another v. State of U.P. and Others, [1997] 2 SCC 715 (referred to hereafter as "Vam Organics - 1").

We now come to the present appeals which arise from Writ Petitions filed by the respondents in the High Court between 1982 to 2000 challenging the levy of denaturation fee under Rule 3(a) on the ground, that the State legislature did not have the legislative competence to legislate on denatured spirit and that the fee of 15 paise per litre was in the nature of tax and in any event excessive. The State countered the challenge and submitted that it had the power to impose the fee in exercise of its regulatory powers since it was necessary to see that the denatured spirit was not re-natured into potable alcohol. It was also contended that unless the State took steps to prevent diversion of denatured spirit, heavy loss would be caused to the exchequer of the Government and it would amount to a health hazard if the re-natured spirit was consumed.

The High Court allowed the writ petitions. It held, - following Synthetic's case (supra), that Parliament alone can legislate in respect of liquor which is unfit for human consumption, and that the State Government can only charge regulatory fees for the purpose of payment of salary for the staff and to see that no non-potable alcohol is converted into potable alcohol. However, it held that the burden of showing that there is a broad co-relation between the fee charged and administrative expenses for imposing regulatory fee is on the State Government. It was noted that the respondents were already paying a fee under Rule 2 for denaturation of spirit. It was noted that the process of re-naturation of denatured spirit was involved and extremely difficult and that "it is not averred in the counter-affidavit that any additional staff has been employed for seeing that denatured spirit is not renatured. At any event, no co-relation at all (what to say of broad co-relation) has been shown between the charge of 15 paise per litre and any additional expenses incurred by the department". The additional fee sought to be levied was, in the High Courts opinion, really a tax in the garb of a regulatory fee. This conclusion was arrived at after considering the pleadings and in particular the lack of any averment in the counter affidavit filed by the appellants justifying levy of the additional fees under Rule 3(a).

Impugning the High Court's decision, the appellants have contended that it is possible to renature denatured spirit. They have referred to the decision of Synthetics (supra) to contend that the possibility of re- naturation has been recognised by this Court in that decision. Instances of the illicit sale of denatured spirit after renaturing for human consumption have been cited. It is submitted that since the power to levy excise on potable alcohol vests solely in the State, there must be a power to take steps to ensure that the denatured spirit remains denatured. It is submitted that in fact special services had been rendered by the State in return for the licence fee levied under Rule 3(a). It

is also contended that even if there were no quid pro quo, nevertheless a regulatory fee can be charged unless the fee was expropriatory or excessive in which case the burden of proof would be on the assessee to show that the fee was excessive. According to the appellants, the word 'industry' has been construed by the Constitution Bench in ITC Ltd. v. Agricultural Produce Market Committee & Ors., [2002] 9 SCC 232 para 136 to mean only manufacture and production. Therefore, the State was legislatively competent under the provisions of Entry 33 List III of the Seventh Schedule to the Constitution to regulate the products of an industry which was declared to be controlled industry under Entry 52 of List -I. Since there was no central legislation occupying the field, the State law must be held to be valid.

The respondents have supported the decision of the High Court and submitted that once industrial alcohol is denatured, it is permanently unfit for human consumption. They have referred to the definition of denatured spirit in IS :324/1959 which says "spirit with added denaturants to render it effectively and permanently unfit for human consumption". A reference is also made to the "Encyclopedia of Chemical Processing and Design" which defines denaturing as a permanent process. According to the respondents this was also the stand of State - appellants in Vam Organics-I. It is submitted that the respondents were already denaturing the entire quantity of industrial alcohol and paying fee under Rule 2 for that purpose. That fee had been justified in Vam Organics-I as necessary to meet the cost of ensuring denaturation of the industrial alcohol and there was no scope for further regulation. It is also submitted that assuming that the fee was regulatory, there was no material whatsoever produced by the State- appellants to establish that the fee levied under Rule 3(a) was necessary to meet the cost of any extra or additional expenditure by the State. According to the respondents, the clarificatory order dated 6.5.91 passed by this Court in WP No. 2423 of 1980 had been accepted and acted on by the State as far as Synthetic & Chemicals Ltd. was concerned. It is their contention that the decision in Synthetic & Chemical Ltd. WP 2423/ 1980 was a judgment in rem, the benefit of which should be available to all industries which were similarly situated as Synthetic & Chemicals Ltd. With regard to the State's justification for the levy on industrial alcohol or denatured spirit under Entry 33 of List III to the Seventh Schedule of the Constitution, it is submitted that the same argument had been expressly negatived by the Constitution Bench in Synthetic's Case. Article 246 gives to the Parliament exclusive power to make laws with respect to the matters enumerated in List I in the Seventh Schedule. Entry 84 of List I and Entry 51 of List II were construed by this Court in Synthetic's case to hold that Parliament alone has the exclusive power to legislate and levy excise tax in respect of industrial alcohol. It is unnecessary to refer to the law with regard to the comparative competence of the Union and the States with regard to levy of excise, regulation and control of industrial alcohol prior to the decision of the Constitution Bench in Synthetics. Whatever the law was earlier, the decision in Synthetics now holds the field. In that decision the State's power to levy excise duty was held to be limited by Entry 51 to tax on alcoholic liquors for human consumption. It was also held that Section 2 of the Industries (Development and Regulation) Act, 1951 as well as Serial No. 26 of the First Schedule to that Act covered the whole field on industrial alcohol and its products. Therefore since the coming into force of the IDR Act on 8th May 1952 the State Legislatures are constitutionally incompetent to levy any tax on industrial alcohol.

The principle was succinctly reiterated in State of U.P. v. Modi Distillery, [1995] 5 SCC 753 where it was said that the State's power to levy excise duty was limited to alcohol of liquor for human consumption and "that the framers of the Constitution, when they used the expression 'alcohol liquors for human consumption', meant, and the expression still means, that liquor which, as it is, is consumable in the sense that it is capable of being taken by human beings as such as a beverage or drink"....."Dictionaries and technical books showed that rectified spirit (95 per cent) was an industrial alcohol and not potable as such..." Therefore even if ethyl alcohol (95 per cent) could be used as a raw material or input, after processing and substantial dilution, in the production of whisky gin, country liquor, etc. nevertheless it was not 'intoxicating liquor' which expression meant only that liquor which was consumable by human beings as it was". Thus the State cannot legislate on industrial alcohol despite the fact that such industrial alcohol has the potential to be used to manufacture alcoholic liquor.

A somewhat contrary view was taken by a Bench of two Judges of this Court in Bihar Distillery v. Union of India, [1997] 2 SCC 727. It was held that the decision in Synthetics did not deal with rectified spirit which could be converted into potable alcohol and was merely concerned with industrial alcohol which could not be so converted i.e.denatured rectified spirit. A distinction was drawn between industries engaged in manufacturing rectified spirit meant exclusively for supply to industries (industries other than those engaged in obtaining or manufacturing of potable liquor), whether after denaturing it or without denaturing it and industries engaged in manufacturing rectified spirit exclusively for the purpose of obtaining or manufacturing potable liquor. In the first case, the industry was to be under "the total and exclusive control of the industries and be governed by the IDR Act and the rules and regulations made thereunder". As far as the second case is concerned, "they shall be under the total and exclusive control of the State in all respects and at all stages including the establishment of the distillery".

The decision in Bihar Distillery was doubted in Deccan Sugar & Abkari Co. Ltd. v. Commissioner of Excise, A.P., [1998] 3 SCC 272. It was said that the decision in Bihar Distillery's ran counter to the scheme of legislative competence as examined by the Constitution Bench of this Court as well as in the three-Judges Bench decision of this Court in Modi Distillery". The appeals were accordingly referred to a larger Bench for re-consideration of the judgment in Bihar Distillery's case.

The larger Bench followed Synthetics and Modi Distillery without expressly overruling the decision in Bihar Distillery1. We therefore proceed on the basis that the decision in Synthetics continues to exclude the State from levying tax on industrial alcohol whether or not it has the potential to be used as alcoholic liquor.

However Synthetics has also said "...the States have the power to regulate the use of alcohol and that ower must include power to make provisions to prevent and/or check industrial alcohol being used as intoxicating or drinkable alcohol".

In summing up the law the Constitution Bench said :

"The position with regard to the control of alcohol industry has undergone material and significant change after the

1. Deccan Sugar & Abkari Co. Ltd. v. Commissioner of Excise, A.P.C.A. No. 4355 of 1985 unreported decision dated 13th February, 2002 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 [1971] 2 SCC 236.

The State's power is thus limited to (i) the regulation of non potable alcohol for the limited purpose of preventing its use as alcoholic liquor and (ii) the charging of fees based on quid pro quo. The question then is - is the levy under Rule 3(a) of the 1976 rules justifiable as such fee?

The locus classicus on the distinction between a 'fee' and a 'tax' is the decision of this Court in The Commissioner, Hindu Religious Endowments, Madras v. Sri Lakshmindra Thirtha Swamiar of Sri Shirur Mutt, [1954] SCR 1005. In that case the subject matter of challenge was, inter-alia, Section 76 of the Madras Hindu Religious and Charitable Endowments Act, 1951 under which religious institutions were required to make a contribution at 5 per cent of their income towards the services rendered by the Government and its officers. According to the State this annual contribution was a fee for overseeing the working of the religious institutions. According to the religious institutions, the levy was a tax which the State was incompetent to impose. The distinctive characteristics of a tax and fee were laid down. As far as a fee is concerned it was held that:

a fee is generally defined to be a charge for a special service rendered to individuals by some governmental agency. The amount of fee levied is supposed to be based on the expenses incurred by the Government in rendering the service, though in many cases the costs are arbitrarily assessed. Ordinarily, the fees are uniform and no account is taken of the varying abilities of different recipients to pay. These are undoubtedly some of the general characteristics, but as there may be various kinds of fees, it is not possible to formulate a definition that would be applicable to all cases".

However, the Court made it clear that the service need not necessarily be one which is voluntarily taken by the person responsible for paying the fee. There may be an element of compulsion or coerciveness present "if in the larger interest of the public, a State considers it desirable that some special service should be done for certain people, the people must accept these services, whether willing or not".

This Court struck down Section 76 on the ground that the annual contribution was a tax as there was "total absence of any co-relation between the expenses incurred by the Government and the amount raised by contribution under the provision of section 76 and in these circumstances the theory of a return or counter payment or quid pro quo cannot have any possible application to this case."

The word "service" in the context of a fee could, therefore, include therefore a levy for a compulsory measure undertaken vis-a-viz the payer in the interest of the public. This 'coercive' measure has been subsequently judicially clarified to mean a 'regulatory measure'. But in the case of both kinds of services whether compulsorily imposed or voluntarily accepted, there would have to be a correlation between the levy imposed and the"counter payment or quid pro quo" However, correlationship between the levy and the services rendered is one of general character and not of mathematical exactitude. All that is necessary is that there should be a reasonable 'relationship' between levy of the fee and the service rendered"2. Contrariwise when there is no such correlation, the levy, despite its nomenclature is in fact a tax. In The Corporation of Calcutta v. Liberty Cinema, AIR (1965) SC 1107. The licence fee charged under Section 548 of the Calcutta Municipal Act 1951 had been challenged on the ground that no service was rendered commensurate with the tax. This Court said that the levy was a tax which the State was competent to impose.

"the Act does not provide for any services of special kind being rendered resulting in benefits to the person on whom it is imposed. The work of inspection done by the Corporation which is only to see that the terms of the licence are observed by the licencee is not a service to him. No question here arises of correlating the amount of the levy to the costs of any service. The levy is a tax. It is not disputed, it may be stated that if the levy is not a fee, it must be a tax". (Para 20) This test of correlationship or "correspondence" has been repeatedly used by this Court either to uphold the fee holding that it was reasonable for the requirement of the authority for fulfilling its statutory obligations (B.S.E. Brokers Forum v. Securities and Exchange Board of India, [2001] 3 SCC 482, p. 505); Secunderabad Hyderabad Hotel Owners' Assn. v. Hyderabad Municipal Corpn., [1992] 2 SCC 274, 286; State of Tripura v. Sudhir Ranjan Nath, [1997] 3 SCC 665; Shri Bileshwar Khand Udyog Khedut Sahakari Mandali Ltd. v. State of Gujarat, [1992] 2 SCC 42; M/s. Gujchem Distillers India Ltd. v. State of Gujarat, [1992] 2 SCC 399 or to strike it down on the ground that the fee charge was not established to be so commensurate. (See : Indian Mica Micanite Industries v. State of Bihar, [1971] 2 SCC 236, 243; A.P. Paper Mills Ltd. v. Govt.of U.P., [2000] 8 SCC 167.

The respondents correctly objected to the States' contention that the levy of tax on industrial alcohol and its products is competent under Entry 33 of List III. The issue was not raised before the High Court and was raised before us only in reply. The arguments had been specifically raised before the Constitutional Bench in Synthetics and expressly negatived where the 2. Sreenivasa General Traders v. Slate of A P., [1983] 4 SCC 353 State's contention was that the levy was stipulated "jointly or severally both under entries 8 of List II, Entry 51 of List II, Entry 33 of List III and what is described as police powers regulatory and other incidental charges according to them", (para 46).

In rejecting the submission the Constitution Bench said : "Under the constitutional scheme of division of powers under legislative lists, there are separate entries pertaining to taxation and other laws. A tax cannot be levied under a general entry". It was also held that the power to tax is neither incidental nor subsidiary to the power to legislate on a matter or topic. Since there was no such specific entry allowing the State to tax industrial alcohol it could not derive the power from any other entry. It was said that the state cannot also claim that, it can regulate industrial alcohol and a product of the scheduled industry, under Entry 33 of List III because the Union, under Section 18G or the IDR Act, has evinced clear intention to occupy the whole field. Given this clear enunciation of the law, the submission of the State must be rejected.

Both the sides have relied heavily on the decision of this Court in Vam Organic Chemicals Ltd. and Another v. The State of Uttar Pradesh and Others, [1996] 2 SCC 715. Since the decision has basically and briefly affirmed the reasoning of the High Court, we take up the High Court's decision for consideration before determining what this Court has in fact held. The subject matter of challenge in Vam Organic-I was the notification amending Rule 2 of the Rules by which licence fee @ 7 paise per litre was sought to be imposed w.e.f. 2nd June 1990. It was contended that the State Legislature had no power to impose the fee as the industrial alcohol which was produced by the petitioner was not fit for human consumption. In answer to the challenge, the State's contention as recorded by the High Court was as follows :

"According to the respondents, this process of denaturing, to render the rectified spirit unfit for human consumption, has been in vogue since 1863. The have also set out the process by which, and the chemicals by mixing which, the rectified spirit is converted into denatured spirit or especially denatured spirit, as in the case may be. According to the respondents, however, the denaturing is necessary to preclude the mis-use of rectified spirit for drinking purposes. They go further and say that even after denaturing, it is necessary to ensure that denatured spirit is not re-natured to render it fit for human consumption. It is towards this regulation and service, the respondents say, that they are charging the impugned fee."

The High Court said that the State was competent to frame regulations under Entry 6 as well as Entry 8 of List II of the Seventh Schedule of the Constitution to ensure that "ethyl alcohol/rectified spirit, which is proposed to be used for industrial purposes, should be denatured first so that is cannot thereafter be used for obtaining country liquor or for manufacturing IMFLs. The State, thus, draws a dividing line. It says that all ethylic alcohol/rectified spirit, which is proposed to be used for industrial purposes, should be denatured first. Once denatured, it cannot be used except for industrial purposes. Once denatured, it goes out of the seisin of the State Legislature. But, the State over-sees the process of denaturing so that quantity of rectified spirit is no longer available for obtaining or producing potable liquors. Rule 2 provides for such regulation and also charges, what it calls, a licence fee thereof.

In this background, the High Court held that :

> "The subject and purpose underlying the impugned impugned rule is to ensure that rectified spirit sought to be used for industrial purpose is used only for that purpose and is not diverted or misused for obtaining country liquor or for manufacturing other IMFLs.....
>
> This is a regulation made in the interest of public health (Entry 6 of List II). It is also a law with respect to possession and sale of intoxicating liquors-Entry 8 of List II.

The High Court was also of the view that Section 18-G of the IDR Act did not operate on different fields. The reasoning of the High Court in Vam Organics I has been adopted by the same learned Judge and Bihar Distillery's case. We have already noted that the reading in construction and consequent limitation of Synthetics in Bihar Distillery has been disapproved and can safely be said not to represent the law. However, Vam Organics I also had held that the State was competent to regulate industrial alcohol so that it was not converted into potable liquor, the High Court also found that the State was competent to levy a fee for the purpose. It was held that the fee could be levied not only for services rendered but also towards the cost of regulation. In the first case, the element of quid pro quo is necessary but in the second case, the fee must be reasonable. The High Court then said :

> "The question then arises, how to judge the reasonableness of such a fee. In our opinion, it would be appropriate, in such a case, to look to the expenditure which the State undergoes for administering the regulation, and if we find that there is a broad co-relation between the expenditure and the fees charged, we should sustain the same".

The Court noticed the facts stated in the counter affidavits particularly setting up of a Headquarters laboratory and deployment of a good number of officers and employees who were engaged in manning the laboratory besides the staff which is posted at the distilleries. There was, according to the High Court, a broad co-relationship between the amount of fee charged and the expenses incurred for implementing and over seeing the regulation. The challenge to the levy of licence fee under Rule 2 was accordingly dismissed. As we have noted the appeal of Vam Organic was

dismissed by this Court affirming this reasoning of the High Court because it found no reason to differ with it.

Considering the various authorities cited, we are of the view that the State Government is competent to levy fee for the purpose of ensuring that industrial alcohol is not surreptitiously converted into potable alcohol so that the State is deprived of revenue on the sale of such potable alcohol and the public is protected from consuming such illicit liquor. But this power stops with the denaturation of the industrial alcohol. Denatured spirit has been held in Vam Organics I, to be outside the seisin of the State Legislature. Assuming that denatured spirit may by whatever process be renatured. (a proposition which is seriously disputed by the respondents) and then converted into potable liquor this would not give the State the power to regulate it. Even according to the demarcation of the filed of legislative competence as envisaged in Bihar Distillery industrial alcohol for industrial purposes falls within the exclusive control of the Union and according to Bihar Distillery "denatured spirit, of course, is wholly and exclusively industrial alcohol".

Besides, the fee is required to be justified with reference to the cost of such regulation. The industry is already paying a fee under Rule 2 for such regulation. Indeed the justification for levying the fee under Rule 3(a) is the identical justification given by the State for levying the fee under Rule 2. Presumably, a full complement of Excise Officers and staff are appointed by the State in the Excise Department to carry out their duties under the Act to oversee, control and keep duty on the various kinds of intoxicants under the Act. Having regard to the decision in Vam Organics I, we must also assume that apart from the normal strength, additional officers and staff were appointed to regulate the denaturation of the industrial alcohol. There is nothing to show that there has been any deployment of any additional staff to over-see the possibility of renaturation of the denatured spirit.

The question is (to borrow the language is Synthetics) whether in the garb of regulations a legislation which is in pith and substance, as we look upon the instant legislation, a fee or levy which has no connection with the cost or expenses administering the regulation, can be imposed purely as a regulatory measure. Judged by the pith and substance of the impugned legislation, we are definitely of the opinion that these levies cannot be treated as part of regulatory measures." The State has not produced any material to show that it was incurring any additional cost for any further regulation of denatured spirit. Any trace of a lingering doubt as to the propriety of the levy under Rule 3(a) must be taken to have been noted off effectively with the order passed by three Judges of this Court in the Writ Petition filed by Synthetics challenging the same levy as we have noted earlier. That order has resulted in granting Synthetics & Chemicals Ltd. relief from payment under Rule 3(a). The only distinction between the present respondents' cases and Synthetics was that the respondents chose to challenge the levy before the High Court. That could be no rational basis for denying the respondents who are otherwise identically situated, the same relief. (See : Anil Kumar Neotia v. Union of India, [1998] 2 SCC 587). In the absence of any such correlation the fee under Rule 3 is not a fee at all levied for the purpose of additional regulation or for any service rendered but is really a tax in the garb of a fee.

The appeals must therefore be and are hereby dismissed. It appears from the records that since 1982 the High Court had passed interim orders in the series of writ petitions filed by the respondents

challenging the validity of the imposition of the licence fee, staying the impugned levy. Separate writ petitions were filed in respect of the assessment years and interim orders obtained in respect of each year. For the excise year 1994-95 initially an order was passed staying the levy of the impugned licence fee subject to the respondents furnishing adequate security. This order was clarified on 2.9.1984 by allowing the respondents to furnish bank guarantee in respect of the licence fee for the excise year in question subject to which the levy was stayed. For the subsequent years the same interim order was passed. The respondent had therefore made no payment to the appellant of the licence fee but had furnished several bank guarantees which were kept renewed until the disposal of all the writ petitions by the High Court. After allowing the writ petition the High Court directed the discharge of the bank guarantees. Although this order was stayed when the appeal was admitted by this Court on 25.9.2000, there has been no collection of the disputed levy by the appellants. There is as such no question of any refund being directed of any amount by the appellant to the respondents. Where the levy itself has been held to be invalid, the State- appellant cannot be permitted to realize the amount recovered by the bank guarantees (See : Somaiya Organics v. State of U.P., [2001] 5 SCC 519 para

35). We therefore dismiss these appeals with costs and direct that the bank guarantees furnished by the respondents will stand discharged.