

Kerala High Court

State Of Kerala vs Universal Enterprises on 21 December, 2006

Equivalent citations: (2008) 11 VST 439 Ker

Author: C R Nair

Bench: C R Nair, K Joseph

JUDGMENT C.N. Ramachandran Nair, J.

1. The short question arising in these connected tax revision cases pertaining to two assesseees is whether they are liable to pay purchase tax under Section 5A of the Kerala General Sales Tax Act, 1963, hereinafter called "the Act" on the purchase turnover of red oil which was converted by them in their factory to sandalwood oil and sold by them as such. The assessments pertain to the years 1989-90 to 1995-96. Since the main order of the Tribunal is produced in T.R.C. No. 419 of 2000 the facts referred to in the said T.R.C. are considered by us for our decision. In fact all the subsequent orders of the Tribunal are based on their order produced in T.R.C. No. 419 of 2000.

2. The assesseees were admittedly engaged in massive purchase of red oil from unregistered dealers who have not collected or remitted any sales tax on their sales to the assesseees. Red oil is manufactured out of sandalwood, source of which is only forest in Kerala and Karnataka. In fact the assessing officer rightly pointed out that layman from whom assesseees claimed to have purchased red oil cannot produce and sell the same because red oil can be extracted from sandalwood through an elaborate process which could be done in a factory. It is a notorious fact that accounted sandalwood oil production has no relation to the quantity of sandalwood sold by the Forest Department and instances of theft of sandalwood from forest with the patronage of Government officials and production of oil from it in factories run clandestinely in Kerala were hitting the headlines of newspapers. Even though enquiry could have been conducted and assesseees should have been made to disclose the identity of persons who supplied red oil to them, failing which the source of red oil could have been attributed to the very same assesseees, the assessing officer even after doubting the genuineness of the transactions accepted the purchases and levied tax under Section 5A of the Act on the purchase turnover of red oil on the ground that the assesseees have consumed red oil in the manufacture of their final product, namely, sandalwood oil. The case of the assesseees is that the process of manufacture of sandalwood oil is only removal of impurities and water from red oil by heating it. However, it is admitted fact that assesseees have established factories and used steam generated in boilers for heating the raw material, namely, red oil to make sandalwood oil. It is also conceded that assesseees are registered under the Central Excise Act and are remitting excise duty on the manufactured product, namely, sandalwood oil. The main reason for the first appellate authority for holding that there is manufacture of product is the payment of excise duty by the assesseees. The contention of the assesseees before the Tribunal was that there was no chemical use in the manufacture and all what is achieved in the process engaged in the factory is removal of impurities and water from red oil. The assesseees relied on several decisions including that of the Supreme Court in *Tungabhadra Industries Ltd. v. Commercial Tax Officer* [1960] 11 STC 827. The Tribunal accepted the contentions of the assesseees and held that there was no manufacture of a new product as the process involved did not involve use of any chemical and all what the assesseees have done is removal of impurities and water from red oil.

3. We have heard Special Government Pleader appearing for the State-revision petitioner in all the cases, and Senior Counsel Sri. C. Natarajan, appearing for the assesseees. While the Special Government Pleader contended that process done in the factory of the assesseees amounts to manufacture of a new product, namely, sandalwood oil, from the raw material, that is, red oil and relied on the decision of the Supreme Court in Assistant Commissioner (Intelligence) v. Nandanam Construction Co. [1999] 115 STC 427 and the Division Bench decision of this Court in State of Kerala v. Cochin Shipyard Limited . Counsel for the assesseees advanced the same contentions that were raised by them before the Tribunal.

4. So far as the controversy on manufacturing process, we do not think the contention of the assesseees that the process involved is simple removal of water and impurities from the red oil is acceptable because if the process is so simple, we see no reason why a factory with equipments and boilers should be established for this process. The minimum process engaged as evident from the admitted facts is steam distillation of red oil to separate water and sandalwood oil as the raw material is a mix of both. No doubt red oil which is a crude product distilled from sandalwood is still a raw material used for the manufacture of sandalwood oil and it is not a product fit for any application. Therefore red oil, the raw material, and sandalwood oil, the final product, are commercially different. There is substantial value difference between the raw material and the final product which is evident from the purchase value accounted by the assesseees for raw material and the value of the final product received by them on sale. Even though assesseees contention that manufacture under the Excise Act is not the same as manufacture under Section 5A of the Act, which found acceptance with the Tribunal, we are unable to uphold the claim of the assesseees upheld by the Tribunal, because assesseees have not made any claim that excise duty is paid by them without any dispute by virtue of any special provision in the Excise Act providing for duty in respect of any other activity other than manufacturing in this case. Even though counsel for the assesseees relied on large number of decisions of the Supreme Court and High Courts particularly in Alladi Venkateswarlu v. Government of Andhra Pradesh ; Deputy Commissioner of Sales Tax (Law), Board of Revenue (Taxes), Ernakulam v. Pio Food Packers ; State of Tamil Nadu v. Subbaraj and Co. ; Chowgule & Co. Pvt. Ltd. v. Union of India ; Commissioner of Sales Tax, U.P. v. Prag Ice and Oil Mills [1991] 80 STC 403 (SC); Deputy Commissioner of Sales Tax, Ernakulam v. Mohan Jewellery [1997] 105 STC 29 (SC); Raja Provision Stores v. Appellate Tribunal (Sales Tax), Trivandrum ; B.P. Oil Mills Ltd. v. Sales Tax Tribunal ; Union of India v. Delhi Cloth and General Mills Co. Ltd. ; Kathiawar Industries Ltd. v. Jaffrabad Municipality ; Deputy Commissioner of Sales Tax v. A.B. Ismail ; State of Kerala v. Namputhiris Pickle Industries ; Collector of Central Excise, Guntur v. Aruna Straw Boards (P.) Ltd. ; Premji Haridas & Co. v. Municipal Corporation of Greater Bombay ; Commissioner of Central Excise v. Markfed Vanaspati & Allied Industries ; Shyam Oil Cake Ltd. v. Collector of Central Excise ; Tungabhadra Industries Ltd. v. Commercial Tax Officer, Kurnool ; Deputy Commissioner of Sales Tax v. Kunhalavi & Co. ; Deputy Commissioner of Sales Tax v. Mohan Jewellery and Anwarkhan Mahboob Co. v. State of Bombay , we do not find any decision directly applicable to the facts of this case. In fact Supreme Court has, though in the context of the Income-tax Act in Aspinwall and Co. Ltd. v. Commissioner of Income-tax case , held that just removal of husk/covering from coffee berry to separate coffee beans is a manufacturing activity. Apart from this decision, in large number of decisions, the Supreme Court has held that the process of making goods commercially different from raw material with distinct name, character and use,

amounts to manufacture of a product. Moreover, the scope of purchase tax liability under Section 6A of the Andhra Pradesh General Sales Tax Act which is the same as Section 5A of the Kerala General Sales Tax Act, is explained by a Constitution Bench of the Supreme Court in the decision in Assistant Commissioner (Intelligence) v. Nandanam Construction Company reported in [1999] 115 STC 427. In the said decision, the Supreme Court has held that once the goods purchased by the dealer are used in construction and cease to be available in that form for sale or purchase again to attract tax, the liability for purchase tax is attracted. This decision is followed by a Division Bench of this Court in State of Kerala v. Cochin Shipyard Limited wherein this Court upheld the levy of purchase tax on the purchase turnover of water by Cochin Shipyard Ltd., though water purchased was not consumed in the manufacture of any commodity. In fact it is to be noted that by the 1989 amendment Section 5A was amended to bring within the scope of purchase tax, items purchased from unregistered dealers without payment of tax for "use". Section 5A with its amendment is extracted hereunder for easy reference:

5A. Levy of purchase tax.--(1) Every dealer who, in the course of his business, purchase from a registered dealer or from any other person any goods, the sale or purchase of which is liable to tax under this Act, in circumstances in which no tax is payable under Sub-sections (1), (3), (4) or (5) of Section 5 and either,-

(a) consumes such goods in the manufacture of other goods for sale or otherwise; or

(b) uses or disposes of such goods in any manner other than by way of sale in the State; or

(c) despatches them to any place outside the State except as a direct result of sale or purchase in the course of inter-State trade or commerce; shall, whatever be the quantum of the turnover relating to such purchase for a year, pay tax on the taxable turnover relating to such purchase for the year at the rates mentioned in Section 5.

(2) Notwithstanding anything contained in Sub-section (1), a dealer (other than a casual trader or agent of a non-resident dealer) purchasing goods, the sale of which is liable to tax under Section 5, shall not be liable to pay tax under Sub-section (1) if his total turnover for a year is less than two lakh rupees.

5. From Clause (a) of Section 5A(1) above, it is clear that liability is attracted when goods purchased are consumed in the manufacture of other goods for sale. Since we have found above that assesseees have purchased raw material, namely, red oil and have consumed the same in the manufacture of sandalwood oil sold by them as final product, liability is attracted on the purchase turnover of red oil under Section 5A(1)(a) of the Act. Assuming that assesseees' contention that there is no consumption as such of red oil in the manufacture of sandalwood oil is correct, it is admitted that red oil which has not suffered tax has ceased to exist after the same is used up in the manufacture of sandalwood oil and therefore liability in any case is attracted under Section 5A(1)(b) of the Act, because use or disposal of the item purchased in any other manner other than by way of sale in the State also attracts liability. As held by the Supreme Court in the above decision, the object of the Section is to rope in liability when the item purchased has not been subjected to any tax until its purchase and

the item ceases to exist after it's use by purchasing dealer. Assessee's case itself is that suppliers are unregistered dealers and red oil purchased by them has not suffered any tax and after red oil is used by them in the production of sandalwood oil, it ceases to exist. Therefore, if purchase tax is not levied at the hands of the assessee, the same will frustrate and defeat the purpose of Section 5A of the Act.

6. We do not know on what basis the Tribunal has assumed that in order to attract liability under Section 5A manufacture of a product should be done with the use of chemicals. We are constrained, to observe that the finding of the Tribunal is patently absurd and perverse.

7. We therefore allow the tax revision cases, reversing the orders of the Tribunal, upholding levy of tax under Section 5A of the Act on the purchase turnover of red oil by respondents-assessee for all the years.