

Levying VAT/GST on ENA: The Undeciphered Saga Continues

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Extra-neutral alcohol (ENA) is a type of food-grade alcohol that is highly distilled and contains more than 95% of alcohol content. It is largely used to manufacture 'alcoholic liquor for human consumption,' such as whiskey, vodka, gin and rum. It is usually produced by fermenting sugarcane molasses or grains by distilling them several times to produce colourless and odourless alcohol.

Now the question that arises here is, 'What is the meaning of alcoholic liquor for human consumption'?

The Honourable Supreme Court, in a landmark judgement of Synthetics and Chemicals Ltd. vs the State of UP^[1], held that the expression 'alcoholic liquor for human consumption' means any liquor which is capable of being consumed by human beings as a beverage or drink. Therefore, industrial alcohols such as ethyl alcohol, which cannot be consumed but can be used as inputs for manufacturing intoxicating liquor after processing and substantial dilution, will not qualify as alcoholic liquor for human consumption.

Besides potable alcohol, ENA is also used extensively for industrial or commercial purposes through blending and distillation processes. The market for industrial alcohol is segmented on the basis of raw materials and its applications. Based on raw material, ENA is primarily used to manufacture industrial alcohol, while the application segment for this market is pharmaceuticals, cosmetics, flavours and fragrances, electronics, printing and many more.

The issue of the taxability of ENA and other rectified spirits^[2] invariably remains under a dispute between the Union and State Legislature. Several contrary clarifications have been issued by various state departments on the taxability of ENA, which have led to more uncertainty in this regard.

Despite clear court rulings, it remains unclear whether Goods and Services Tax (GST) can be levied on ENA. Some believe these spirits should attract GST, while others are of the view that only the respective State Governments can levy tax on them.

Provisions of the Indian Constitution providing powers to the Union and State Legislature for levying taxes and duties on alcohol

Article 246 of the Constitution of India provides exclusive power to the Parliament in making laws with respect to any of the matters enumerated in List I in the Seventh Schedule to the Constitution, referred to as the 'Union List.' However, Entry 84 of List I, which enables the Union Government to levy Excise Duty on various goods manufactured in India, specifically excludes alcoholic liquor for human consumption.

Entry 51 and 54 of List II of the Constitution of India (referred to as 'State List') provide exclusive power to the State Legislature to levy tax on the manufacture and sale of alcoholic liquor for human consumption.

Article 366 (12A) of the Indian Constitution defines the GST as any tax on the supply of goods, services or both – except taxes on the supply of alcoholic liquor for human consumption.

Legal precedences on the taxability of ENA under the pre-GST regime

In the past, this issue of taxability on ENA under state excise has been deliberated in several judgements. In the case of the State of UP vs Modi Distillery^[3], the Apex Court relied upon the judgement of the Constitution Bench in the case of Synthetics and Chemicals Ltd. (supra) and held that the state can levy excise duty on alcoholic liquor fit for human consumption only when its manufacture is complete and not on the raw material or input still in the process of being rendered fit for human consumption.

However, the judgement of the Apex Court in the case of Bihar Distillery and Anr vs Union of India^[4] was distinguished from the landmark case of Synthetics and Chemicals Ltd. (supra) on the point that the latter judgement did not consider spirits that can be diluted to render them fit for human consumption. It was stated that the case of Synthetics and Chemicals Ltd. only dealt with alcohol that could be used for industrial purposes, i.e., denatured rectified spirit. A situation where the rectified spirit would be used entirely for making alcohol fit for human consumption was considered by the court in the case of Bihar Distillery, and it was held that in so far as the spirit was used for manufacturing potable liquor, the power to levy excise duty would vest with the State Governments, thereby, equating such spirits to alcohol fit for human consumption.

Hon'ble Patna High Court, in the case of New Swadeshi Sugar Mills Ltd. vs the State of Bihar^[5], held that ENA, an industrial item, can be put to diverse commercial use other than human consumption and is rendered fit for human consumption only after it is used as raw material. The Division Bench examined various constitutional provisions and reached the conclusion that no state excise duty can be levied on ENA before it is rendered fit for human consumption.

Furthermore, a three-Judge Bench examined the issue in the case of Deccan Sugar and Abkari Co. Ltd. vs Commissioner of Excise, A.P.^[6] and upheld the validity of the decision of the Constitution Bench in the case of Synthetics and Chemicals Ltd. (supra) without expressly overruling the judgement of Bihar Distillery (supra).

Upon perusal of the aforementioned rulings, it is still not clear whether the taxability of ENA would fall under the State or Union Legislature, as the Apex Court has pronounced contrary rulings in different cases.

Quandary around taxability on ENA post-GST

The applicability of GST on ENA has been a raging issue since the introduction of GST.

Section 9(1) of the Central Goods and Services Tax (CGST) Act, 2017 and Section 5(1) of the Integrated Goods and Services Tax (IGST) Act, 2017 provides that supplies of all kinds of goods and services or both

are liable for levy of GST except the supply of alcoholic liquor for human consumption.

The alcoholic beverages industry is heavily regulated, with excise and other taxes forming an important source of revenue for State Governments. While alcoholic liquor meant for human consumption or potable alcohol has always been out of the scope of GST, its main input, ENA, is a grey area which several analysts assumed could be included. However, major big players in the liquor industry are currently following the practice of levying Value-Added Tax (VAT) on the sale of ENA and are of the view that it does not fall under the ambit of GST since ENA is used as a major input for the manufacture of alcoholic liquor for human consumption.

Under GST, there is no dispute on the levy of tax on denatured ENA (industrial alcohol), and the issue arises only in the case of ENA, which is used for the manufacture of alcoholic liquor meant for human consumption. The sugar industries across India have taken different positions on such undenatured ENA, and even the State Governments do not have a uniform view on the said issue.

Owing to a lack of clarity on the matter, divergent practices are being followed by manufacturers or suppliers where a few of them are paying GST on the sale of ENA while the others are paying VAT/Central Sales Tax (CST), treating it akin to 'alcoholic liquor for human consumption,' a commodity outside the purview of GST.

These divergent practices have wide implications on revenue, and hence the issue has been deliberated several times in various GST Council meetings.

So, the primary concern that arises is whether levying VAT/CST on the sale of undenatured ENA can be considered a correct practice or whether GST is leviable on the supply of undenatured ENA.

The GST rates notified vide Notification No.1/2017 - Central Tax (Rate)[[\[7\]](#)] prescribe a rate of 18% for ethyl alcohol and other spirits, denatured, of any strength covered under Chapter Heading 2207. This entry will cover only those spirits which are denatured, and therefore undenatured ENA will not be covered under this entry. It is important to note that there is a residual entry provided in Schedule III Sl.no.453 of the said notification covering goods of any chapter which are not specified in Schedule I, II, IV, V or VI. Since undenatured ENA (HSN 2207) is not specifically covered under any of the above schedules, it is unclear whether it can be covered under Sl.no.453 of Schedule III and be taxed at 18% GST.

Further, in the year 2018, the Himachal Pradesh (HP) Government, through a clarification([\[8\]](#)), stated that 18% GST would be applicable on the supply of ENA, which is used for the manufacture of alcoholic liquor meant for human consumption. This clarification has been issued after obtaining a legal opinion from the Attorney General of India. The impact of clarification of the HP Government may legally not apply to other states, but it would further raise the following two issues:

1. Whether all State Governments will agree to this as this would otherwise mean non-levy of GST on ENA
2. The role and decision of the GST Council would be said to have been encroached upon as it is the GST Council that will decide whether particular goods or services will be included within the ambit of GST

In the GST regime, the issue of the taxability of ENA has also come up before the Telangana Authority of Advance Ruling in the case of Madhucon Sugar and Power Industries Ltd([\[9\]](#)). However, the Authority refused to decide on the matter since the issue is pending before the GST Council for a decision.

Against this backdrop, the Allahabad High Court has pronounced a decision on the issue in the case of M/s Jain Distillery Private Limited vs the State of UP and five others([\[10\]](#)).

The Division Bench of the Allahabad High Court relied upon the judgement of the Constitution Bench in the case of Synthetics and Chemicals Ltd. (supra) and held that ENA is not covered under 'alcoholic liquor for human consumption' and therefore is subject to GST. The court further stated that upon the enactment of the 101st Constitutional Amendment, the state had lost its legislative competence to

impose taxes on the sale of ENA.

The said decision has opened a floodgate of questions for the manufacturers/suppliers of ENA across the country who have been paying VAT/CST on the sale and also the buyers who have been availing credits of such VAT and setting it off against the VAT payable on the sale of alcoholic beverages.

Our views-

The question concerning the taxability of ENA has been the subject matter of deliberation since the 20th GST Council Meeting. Even in the 43rd GST Council Meeting, it was decided to maintain the status quo on the taxability of ENA by allowing the State Governments to continue levying VAT and CST, but no official clarification was issued in this regard. Therefore, in the absence of any clarification by the GST Council, the undeciphered saga continues.

The Allahabad High Court, in the case of Jain Distillery, held that ENA is not covered under 'alcoholic liquor for human consumption' and therefore is subject to GST. However, this issue will attain finality only when it reaches the Supreme Court and a final decision is pronounced on the matter.

On ENA being taxed to GST, the alco-beverages sector will enter into another complex situation, viz, ENA as an input will be subjected to GST, whereas the output, an alco-beverages, will be out of the GST net, leading to an enhanced cost of production for the taxpayer without any set-off benefit in the form of input taxes under GST. However, the VAT paid on the purchase of ENA can be used as a set-off from the VAT payable on the sale of potable alcohol.

While ENA is a major input for the alco-beverage sector, it is also used in the cosmetics industry for the manufacturing of perfumes and the pharmaceuticals industry for the manufacturing of cough syrups. In these industries, the ENA will be allowed a set-off, and this will, therefore, be a welcome change.

Needless to say, the legal precedences under the erstwhile regime and the recent ruling of the Hon'ble Allahabad High Court under the GST regime would merit consideration as currently, the liquor industry seeks to continue levy of VAT/CST on ENA, while on the other hand pharmaceuticals, cosmetics and other industries are demanding for inclusion of ENA in the GST net. Accordingly, it is important that the government should issue an official clarification, considering the judicial outcome based on the application of ENA to resolve the ambiguity and avoid undesirable litigations in this matter.

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[1] Synthetics and Chemicals Ltd. vs State of UP

[2] Rectified spirits are a mixture of ethanol (95.6 per cent) and water produced by distillation

[3] State of UP vs Modi Distillery

[4] Bihar Distillery and Anr vs Union of India, LAWS (SC)-1997-1

[5] New Swadeshi Sugar Mills Ltd. vs the State of Bihar

[6] Deccan Sugar and Abkari Co. Ltd. vs the Commissioner of Excise

[7] Notification No.1/2017 - Central Tax (Rate) Central Goods and Services Tax Act, 2017 (28 June 2017)

[8] AG 16/2018-Adv.C dated 23 December 2017

[9] AAR - Telangana: Madhucon Sugar and Power Industries Ltd. (TSAAR Order no.6/2018 dated 02 July 2018)

[10] M/s Jain Distillery Private Limited vs the State of UP and five others

