

Dispute on taxation of extra-neutral alcohol nears resolution

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Partner: Dhruv Gupta, Counsel: Bhargav Mansatta, Senior Associate: Sourabh Kumar

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1 Background

The Goods and Services Tax Council (**Council**), in its 53rd meeting on 22 June 2024, proposed a resolution to a long-standing dispute regarding the taxation of extra-neutral alcohol (**ENA**). It recommended that Section 9(1) of the Central Goods and Services Tax Act, 2017 (**CGST Act**) be amended to specifically exclude ENA from the scope of Goods and Services Tax (**GST**).

When the GST regime was introduced in 2017, '*alcoholic liquor for human consumption*' was deliberately kept outside its purview to safeguard the revenues of the states and allow them to maintain their fiscal independence. This was in alignment with a constitutional amendment made in the same year empowering the states to tax the sale of '*alcoholic liquor for human consumption*' and, by implication, not the sale of '*alcoholic liquor not fit for human consumption*'. This amendment, coupled with the exclusion of '*alcoholic liquor for human consumption*' under the CGST Act, created uncertainty about the status of ENA – whether it would fall under the ambit of Value Added Tax (**VAT**)/Central Sales Tax (**CST**) or would be taxable under the GST regime. This was because ENA is a highly concentrated (92-93%) ethyl alcohol not fit for consumption on its own but is a key raw material used by distilleries to manufacture alcoholic liquor for human consumption.

Due to this ambiguity, some ENA suppliers paid GST while others paid VAT or CST.

The question of taxing ENA under GST has been a debatable point for the Council since the start. States have consistently pushed back on including ENA in GST, preferring to keep it under the older VAT/CST system. This is also in line with the initial legislative intent to protect state revenue derived from alcohol and petroleum products. The Council even sought the Attorney General of India's opinion to resolve the legal intricacies surrounding this issue. The taxation status of ENA was also heavily deliberated upon in multiple meetings of the Council but no clarity had been attained till now with the decision being deferred every time.

A long-standing dispute on taxing extra-neutral alcohol seems to be nearing an end. The Goods and Services Tax Council has proposed a solution to the confusion caused by unclear legislation. This update explores the impact of this issue, highlights unanswered questions, and provides a way forward.



2 Legal journey and impact on taxpayers

In December 2019, another layer of complexity was added to this issue when the state of Uttar Pradesh (UP) issued a notification¹ (**Notification**) proposing to levy UPVAT/CST at the rate of 5% on any non-GST alcohol sold for use in the process of manufacturing alcoholic liquor for human consumption. Many other states issued similar notifications. Consequently, taxpayers were compelled to pay VAT/CST on the sale of ENA to distilleries.

The validity of the Notification was challenged before the Allahabad High Court.² Upon reviewing the constitutional framework, the High Court held that the state government lacked legislative competence to impose VAT/CST on the sale of ENA. The Notification was quashed on the grounds of invalid delegation and legislative incompetence. The High Court also took into account the principles of unjust enrichment and directed the state government to refund the VAT/CST collected on the sale of ENA so far. This decision was challenged by the state government before the Supreme Court and is pending final determination.

Meanwhile, taxpayers were doubly impacted as immediately after the High Court's decision, the state tax authorities changed their stance. On one hand, taxpayers were not granted any refund of the VAT/CST already paid by them following the Notification or otherwise, and on the other hand, they were additionally subjected to proceedings under the CGST Act, alleging suppression of facts with an intent to evade GST. These proceedings culminated in orders imposing 18% GST along with applicable interest and penalty equivalent to the GST demand from July 2017. This was questioned by taxpayers as being unduly harsh with there being no justification for alleging an intention to evade tax and imposing 100% penalty when taxpayers were merely complying with the Notification and paying VAT/CST accordingly.

3 Amendment proposed by the GST Council and the way forward

The issue finally gained the attention of the Council in its 52nd meeting in which the Council recommended an amendment to the GST regime to explicitly exclude ENA from the scope of GST when supplied for manufacturing alcoholic liquor for human consumption. The Law Committee was directed to examine suitable amendments for this purpose. Finally, a concrete recommendation was made in the 53rd Council meeting to amend Section 9(1) of the CGST Act to exclude ENA from the very purview of the GST net.

While this move is a welcome relief bringing clarity to stakeholders, it is yet to be seen how the remaining concerns will unfold. It is currently unclear whether the amendment will be prospective or retrospective in nature and how that will impact taxpayers who had already paid VAT/CST, were denied refund on it, and then had further complied with the GST demand. It will also be interesting to see the stand taken by the state government in the dispute pending before the Supreme Court. To iron out all the kinks, it also becomes necessary to examine whether ENA would automatically be chargeable to VAT/CST, or whether a constitutional amendment to include ENA under the VAT/CST regime would be required. Notwithstanding these issues, the larger dispute on taxation of ENA is finally nearing its end, in a respite for taxpayers, after a long tussle.

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¹ Notification No. KA.NI-2-1793/XI-2-9(134)/17- U.P. Act-5-2008-Order-(80)-2019 dated 17 December 2019 incorporating Entry 1A to Schedule IV of the Uttar Pradesh Value Added Tax Act, 2008. Entry 1A proposed to levy UPVAT/CST on 'Any Non-GST alcohol, when sold for use in the process of manufacture of alcoholic liquor for human consumption against a certificate issued by the Commissioner of State Excise, Uttar Pradesh or by the officer authorised by him in this regard' at the rate of 5%.

² *Jain Distillery Private Limited and Ors. v State of UP and Ors.*, Writ Tax No. 378/2021