



# **Agenda for**

# **20<sup>th</sup> GST Council Meeting**

# **Volume-4**

**5 August 2017**

**New Delhi**





## TABLE OF CONTENTS

<u>Agenda No.</u>	<u>Agenda Item</u>	<u>Page No.</u>
7	Any other agenda item with the permission of the Chairperson	
	xi. Taxation of rectified spirit/Extra Neutral Alcohol (ENA) under GST	4
	xii. Exemption from IGST on import of temporary import of goods	12

# Discussion on Agenda Items

---

## **Agenda Item 7: Any other agenda item with the permission of the Chairperson**

### 7. (xi) **Taxation of rectified spirit/Extra Neutral Alcohol (ENA) under GST**

Extra Neutral Alcohol (ENA) also known as rectified spirit, or ethyl alcohol or neutral spirits, rectified alcohol etc. In India, highly concentrated ethanol or ENA is produced by fermentation of sugars present in the Molasses using Yeast followed by repeated distillation, a process that is called rectification. It is also used for making potable alcohol.

#### **Applications of ENA:**

2. ENA is colourless alcohol and has a neutral smell and taste. It is used:

- a) for production of potable alcohol, *inter alia*, by dilution to appropriate concentration;
- b) in the pharmaceutical and medicament industry;
- c) in flavours and fragrance industry;
- d) to produce distilled vinegar, flavour extracts and concentrates for soft drinks and food products;
- e) manufacture of industrial chemicals viz. Pyridine, Mono Ethyl Glycol (MEG- further used for Polyester Fiber and Films, Packaging Films, Pet bottles, Resins, antifreezes, coolants, aircraft anti-icer and solvents etc);
- f) making Acetic Acid, Ethyl Acetate and Acetic Anhydride (Most of these products are major building block for various agro chemicals and pharmaceuticals products);
- g) for blending with Petrol, to produce Ethanol Blended Petrol (EBP).

3. ENA typically contains 95% alcohol by volume (ABV) (190 US proof). The purity of rectified spirit has a practical limit of 95.6%, **and as such ENA is not fit for human consumption.**

#### **Taxation of alcohol under the Constitution:**

4.1. As per Article 246 of the Constitution of India, Parliament has exclusive power to make 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, the Legislature of any State has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule of Constitution referred to as the “State List”.

4.2. Entry 51, List II (State List) of the Seventh Schedule to the Constitution reads:

“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 manufacture 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”

4.3. The relevant entries in List I (Union list) are:

“7. Industries declared by the Parliament by law for the purpose of defense or for the prosecution of war.”

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

“84. Duties of excise on tobacco and other goods manufactures or produced in India except

(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”

4.4. Further, Article 366 (clause 12A) reads as under:

“12A ‘goods and services tax’ means any tax on supply of goods or services both except taxes on the supply of alcoholic liquor for human consumption”

### **Tax Structure pre-GST:**

5. Prior to 1<sup>st</sup> July, 2017, most States levied VAT at the standard rate on Alcoholic liquors and Beverages and ENA. The VAT Rates on alcohol in various states are as under:

<b>S. No.</b>	<b>State</b>	<b>Description of Goods</b>	<b>VAT Rate</b>
1.	Kerala	Alcoholic Beverages Concentrates	14.5%
2.	Maharashtra	Extra Neutral Alcohol	20%
3.	West Bengal	Negative List (Alcohol and alcoholic beverages)	14.5%
4.	Rajasthan	Foreign Liquor, Indian Made Foreign Liquor and Beer	20% or 30% depending on dealer
5.	Uttar Pradesh	Spirits and Spirituous liquors of all kind including alcohol	32.5%
6.	Assam	Extra Neutral Alcohol	6%
7.	Puducherry	Liquor including IMFL and imported liquor	Nil

6. Prior to 01.07.2017, excise duty @ 12.5% was levied only on ethyl alcohol and other spirits, denatured, of any strength. However, there was no excise duty on ENA, rectified spirit or neutral spirits. However, excise duty @ Rs.750 PMT was levied on molasses which is the raw material for manufacture of ENA. Average yield of ethanol is 235 litres per ton of molasses, and thus ENA had an embedded excise duty of about 6.25%.

7. Thus, pre GST, the total tax incidence on ENA was ranging from 23.25% to 28.75% (embedded central excise duty: 6.25% + VAT: 14.5% to 20% + CST/ octroi, etc. 2.5%).

### **Views of West Bengal on the issue of applicability of GST on ENA:**

8. The case of Bihar Distillery vs Union of India and others, SC, 1997, wherein all state governments were a party, was a landmark case on the issue. This case was the basis for the amendment of the Industries (Regulation and Development) Act, 1951 in 2016, wherein fermentation industries (item 26 of First Schedule of IDR Act, 1951) which was under the control of the Union was removed and given to the State with retrospective effect. [The Industries (Development and Regulation) Amendment Act, 2016 (No 27 of 2016)].

9. The Bihar distilleries case clearly recognizes the jurisdiction of the State with regard to ENA as ENA can be used by both potable and industrial sector equally. Also, it recognizes that without the control of the State, the RS/ENA meant for industrial sector, if not de-natured can easily be diverted to the potable sector illegally.

10. The operative part of the judgment reads as under:

“It is these and many other situations which we have taken into consideration and provided for in the interests of law, public health, public revenue and also in the interests of proper delineation of the spheres of the Union and the states. The line of demarcation can and should be at the stage of clearance/removal of the rectified spirit. Where the removal/clearance is for industrial purposes (other than for manufacture of potable liquor), the levy of duties of excise and all other control shall be of the Union but where the removal/clearance is for obtaining or manufacturing potable liquors, the levy of duties of excise and all other control shall be that of the States. This calls for a joint control and supervision of the process of manufacture of rectified spirit and its use and disposal. We proceed to elaborate: (1) So far as industries engaged in manufacturing rectified spirit meant exclusively for supply to industries [industries other than those engaged in obtaining or manufacture of potable liquors], whether after denaturing it or without denaturing it, are concerned, they shall be under the total and exclusive control of the Union and be governed by the I.D.R. Act and the rules and regulations made thereunder. In other words, where the entire rectified spirit is supplied for such industrial purposes, or to the extent it is so supplied, as the case may be, the levy of excise duties and all other control including establishment of distillery shall be that of the Union. The power of the States in the case of such an industry is only to see and ensure that rectified spirit, whether in the course of its manufacture or after its manufacture, it not diverted or misused for potable purposes. They can make necessary regulations requiring the industry to submit periodical statements of raw material and the finished product [rectified spirit] and are entitled to verify their correctness. For this purpose, the States will also be entitled to post their staff in the distilleries and levy reasonable regulatory fees to defray the cost of such staff, as held by this Court in [Shri Bileshwar Khand Udyog Khedut Sahakari Mandali Ltd. v. State of Gujarat & Anr.](#) [1992 (1) S.C.R. 391] and [Gujchem Distillers India Ltd. v. State of Gujarat & Anr.](#) [1992 (1) S.C.R. 675].

(2). So far as industries engaged in the manufacture of rectified spirit exclusively for the purpose of obtaining or manufacturing potable liquors - or supplying the same to the State government or its nominees for the said purpose - are concerned, they shall be under the total and exclusive control of the States in all respects and at all stages including the establishment of the distillery. In other words, where the entire rectified spirit produced is supplied for potable purposes - or to the extent it is so supplied, as the case may be - the levy of excise duties and all other control shall be that of the States. According to the State governments, most of the distilleries fall under this category.

(3) So far as industries engaged in the manufacture of rectified spirit, both for the purpose of (a) supplying it to industries [other than industries engaged in obtaining or manufacturing potable liquors/intoxicating liquors] and (b) for obtaining or manufacturing or supplying it to Governments/persons for obtaining or manufacturing potable liquors are concerned, the following is the position: the power to permit the establishment and regulation of the functioning of the distillery is concerned, it shall be the exclusive domain of the Union. But so far as the levy of excise duties is concerned, the duties on rectified spirit removed/cleared for supply to industries [other than industries engaged in obtaining or manufacturing potable liquors], shall be levied by the Union while the duties of excise on rectified spirit cleared/removed for the purposes of obtaining or manufacturing potable liquors shall be levied by the concerned State government. The disposal, i.e., clearance and removal of rectified spirit in the case of such an industry shall be under the joint control of the Union and the concerned State to ensure evasion of excise duties on rectified spirit removed/cleared from the distillery. It is obvious that in respect of these industries too, the power of the States to take necessary steps to ensure against the misuse or diversion of rectified spirit meant for industrial purposes [supply to industries other than those engaged in obtaining or manufacturing potable liquors] to potable purposes, both during and after the manufacture of rectified spirit, continues unaffected. Any rectified spirit supplied, diverted or utilized for potable purposes, i.e., for obtaining or manufacturing potable liquors shall be supplied to and/or utilized, as the case may be, in accordance with the concerned State Excise enactment and the rules and regulations made thereunder. If the State is so advised, it is equally competent to prohibit the use, diversion or supply of rectified spirit for potable purposes.

(4) It is advisable - nay, necessary - that the Union government makes necessary rules/regulations under the I.D.R. Act directing that no rectified spirit shall be supplied to industries except after denaturing it save those few industries [other than those industries which are engaged in obtaining or manufacturing potable liquors] where denatured spirit cannot be used for manufacturing purposes.

(6) So far as rectified spirit meant for being supplied to or utilized for potable purposes is concerned, it shall be under the exclusive control of the States from the moment it is cleared/removed for that purpose from the distillery - apart from other powers referred to above.

(7) The power to permit the establishment of any industry engaged in the manufacture of potable liquors including I.M.F.Ls., beer, country liquor and other intoxicating drinks is exclusively vested in the States. The power to prohibit and/or regulate the manufacture,

production, sale, transport or consumption of such intoxication liquors is equally that of the States, as held in McDowell.”

11. With reference to alcoholic liquors for human consumption, the Constitution contained mutually exclusive framework in form of Central Excise and State Excise. While the Central Excise and VAT have been replaced by GST, the exclusion of alcoholic liquors for human consumption has shifted from Excise to GST. Even after introduction of GST, alcoholic liquors for human consumption are excluded from GST and remain exclusive domain of States, as was the case earlier. Therefore, there is practically no difference in distribution of power of taxation as applicable to alcoholic liquor for human consumption is concerned. Accordingly, the legal framework, including the judgement of Supreme Court in case of Bihar Distilleries Vs Union of India, is equally relevant even now. Besides, many States levy excise on RS/ENA except when it is denatured or goes for medicinal or toilet preparations. The point of levy is the point of clearance from the distillery.

12. At present only De-natured RS/ENA has been classified in the 18% list at entry 25: Ethyl alcohol and other spirits, denatured, of any strength. This is giving rise to a situation, where un-denatured alcohol going to the industrial sector is escaping GST.

13. But the proposal that all RS/ENA be subjected to levy of GST even if it goes to the potable sector means defying the above judgment and also creating a huge cascading effect in the potable alcohol sector. Producers of potable alcohol have to exclusively do so due to the stringent conditions of licence under the State Excise Acts. 95% of the raw material cost of alcoholic liquor is due to ENA/RS. Their output, being outside the purview of GST means any tax on ENA means that the entire cost will get included in production of potable alcohol which is already subject to state excise duty. Besides, many States already levy excise duty and even VAT or Sales tax on ENA. In the industrial alcohol sector, there is no such problem as the products are under GST and the manufacturers can avail ITC.

14. Some issues are being raised by distilleries which use molasses to produce ENA/RS. Since molasses is taxed under GST, if ENA is totally left out of GST the tax will increase the cost of ENA. But, if there is a GST levied on ENA meant for industrial use this problem can be easily solved.

15. Unlike other industries, where determining use is a cause for concern, alcohol industry does not face this problem. State excise law requires the clearance of ENA/RS cleared from a distillery for any purpose, be it denatured or pure, required a transport pass/challan/permit to be issued by the Excise authorities. No alcohol can be transported without documents and the destination and nature of clearance is clearly determinable from this document. Therefore, levying of GST meant for industrial purpose can easily be ensured at the source itself. This will be in keeping with the Constitutional provisions and the Supreme Court judgment also.

#### **Views of Central Government:**

16. The Bihar Distillery case of 1997 was of a Division Bench of the Supreme Court. The question of law to be decided by the Court was framed as under:



“The question arising herein is a thorny one. It is also arising frequently. The decision of the larger Constitution Bench of this Court in *Synthetics & Chemicals Ltd. & Anr. Vs. State of U.P. & Ors.* (1990 (1) SCC 109) calls for demarcation of the spheres of the Union and the States particularly in the matter of alcoholic liquors. Recently, this Court has held in *State of A.P. Vs. McDowell* (JT 1996 (3) SC 679) that so far as the intoxicating liquors/potable liquors are concerned, it is the exclusive province of the States. But for manufacturing intoxication liquors, or for manufacturing industrial alcohol as the case may be, one must have to manufacture or purchase alcohol. It is only thereafter that the alcohol is either converted into industrial alcohol (by denaturing it) or into potable liquors by reducing the strength of alcohol (which is normally of 95% purity or above). Indeed, alcohol can be used for industrial purposes even without denaturing it. Saying that States step in only when alcohol becomes potable and not before it leaves a large enough room for abuse apart from difficulties of supervision and regulation. In the matter of licensing too, problems would arise, as to who should licence such industry - whether the Centre alone or the States or both. Having regard to the importance of the question, we think that this is a proper cases where notice should go to all the States who will be heard on this question. The Union of India is already a party to the writ petition.”

17. **Thus, the essential question of law before the Supreme Court in the Bihar Distilleries case was regarding regulation of industries engaged in manufacture of alcoholic liquors.** As against this, the seven Judge Constitution Bench of the Supreme Court in the case of *Synthetics & Chemicals Ltd. etc. vs State of U.P. and Ors.* has observed as under:

“4.2 The expression 'alcoholic liquor for human consumption' was meant and still means that liquor which, as it is, is consumable in the sense capable of being taken by human beings as such as beverage of drinks. Hence, the expression under Entry 84 List I must be understood in the light.

4.3 Constitutional provisions specially dealing with delimitation of powers in a federal polity must be understood in a broad common sense point of view as understood by common people for whom the Constitution is made. In terminology, as understood by the framers of the Constitution and as also viewed at the relevant time of its interpretation it is not possible to proceed otherwise. Alcoholic or intoxicating liquors must be understood as these are, what these are capable of or able to become. By common standards ethyl alcohol (which has 95%) is an industrial alcohol and is not fit for human consumption. The petitioners and the appellants were manufacturing ethyl alcohol (95%) (also known as rectified spirit) which is an industrial alcohol. ISI specification has divided ethyl alcohol (as known in the trade) into several kinds of alcohol. Beverage and industrial alcohols are clearly and differently treated. Rectified spirit for industrial purposes is defined as "spirit purified by distillation having a strength not less than 95% of volume by ethyl alcohol". Dictionaries and technical books would show that rectified spirit (95%) is an industrial alcohol and is not potable as such. Therefore, industrial alcohol which is ethyl alcohol (95%) by itself is not only non-potable but is highly toxic. The range of spirits of potable alcohol is from country spirit to whisky and the Ethyl Alcohol content varies between 19 to about 43 per cent. These standards are according to the ISI specifications. **Therefore, ethyl alcohol (95%) is not alcoholic liquors for human consumption but can**

**be used as raw material input after processing and substantial dilution in the production of whisky, Gin, Country Liquor, etc.”**

18. Finally, the Constitution Bench of the Supreme Court held that:  
“In our opinion, therefore as far as the present case is concerned the State in exercise of powers under Entry 8 of List II and by appropriate law regulate and that regulation could be to prevent the conversion of alcoholic liquors for industrial use to one for human consumption and for purpose of regulation, the regulatory fees only could be justified. **In fact, the regulation should be the main purpose, the fee or earning out of it has to be incidental and that is why the learned counsel appearing for the State attempted to use this terminology by saying that the purpose is regulation, the earnings are incidental but frankly conceded that in fact the earnings are substantial.** In fact in some of the excise laws in the States they have even used terminology relying on the doctrine of privilege and parting with privilege but in my opinion it is not necessary for us to go into those questions in greater detail as we are not here concerned with the trade in alcoholic liquors meant for human consumption and therefore in view of clear demarcation of authority under various items in the three Lists, Entry 8 List II could not be invoked to justify the levies which have been imposed by the State in respect of alcoholic liquors which are not meant of human consumption.”

19. Thus, the seven judge Constitution Bench judgment of the Supreme Court in its aforesaid decision has clearly held that **ethyl alcohol (95%) is not alcoholic liquor for human consumption but can be used as raw material input after processing and substantial dilution in the production of whisky, Gin, Country Liquor, etc.** From this ratio it follows that ENA is not outside the ambit GST, and therefore GST can be levied on supply of ENA, and not only on denatured ethyl alcohol. In fact, unless exempted supply of ENA is liable to 9% CGST and 9% SGST under residual Entry No. 453 of the Schedule III of GST notification no. 1/2017 [rate] dated 28.06.2017 of CGST and SGST respectively.

20. Demand of ENA **for potable purposes** is more than 1000 million litres valued at Rs.6000 crore (@ Rs.60 per litre). At 18% GST rate, this involves revenue of about **Rs.1100 crore.**

21. As regards cascading of taxes, it happens as some of the goods are outside the ambit of GST. If GST is levied on ENA supplied to manufacturers of alcoholic liquors for human consumption, then the cascading would happen at the end of such manufacturers. On the other hand, if there is no GST on ENA supplied to manufacturers of alcoholic liquors for human consumption, then the cascading would happen at the end of ENA manufacturers. In any case, such cascading is bound to happen and it would be advisable to take a holistic view about the same, instead of attempting to resolve it for specific sectors.

#### **Way forward:**

22. From the above views, it transpires that there is no difference of opinion between Centre and State that GST can be levied on ENA supplied for industrial purposes, and supply of ENA for industrial use will attract 18% GST under aforesaid residual Entry. However, to make this

aspect abundantly clear, a separate Entry may be created in respective notifications prescribing 18% GST on ENA for industrial use falling under HS Code 220710.

23. As regards levy of GST on **ENA supplied for manufacture of alcoholic liquor of human consumption**, there is divergence of opinion regarding the Constitutional powers of taxation on such goods. Therefore, GST Council may consider recommending either of the following options:

- (1) To exempt GST on supply of ENA for manufacture of alcoholic liquor for human consumption, or
- (2) To seek legal opinion regarding the taxing jurisdiction of States and the Centre on alcoholic liquor for human consumption under the amended Constitution in view of the GST.

## 7. (xii) Exemption from IGST on import of temporary import of goods

### ISSUE

1. Gujarat Maritime Board is executing a project for RO-PAX ferry between Ghogha to Dahej in the State of Gujarat. The project is financially supported by Gujarat Government and Government of India. The project is believed to be a unique nature leading to modal shift of goods and passengers transport from road/rail to waterways and coastal movement. The project is being executed by M/s. Essar Projects (I) Ltd.

2. To meet the schedule of completion of project GMB has required EPIL to mobilise a suitable sheer leg crane vessel of 5,000 MT lift capacity position between Dahej and Ghogha so as to have the link span installed at the two ports even in adverse weather condition.

3. The sheer leg crane vessel is being imported on lease for a temporary period of one month for the execution of the project. The vessel is likely to attract 5% basic customs duty and 5% IGST. However, it being a temporary import, therefore, customs duty payable would be 5% of the aggregate customs duty. It would be roughly equal to 0.25% and the remaining 4.75% against bank guarantee. **5% IGST would be payable in cash and refunded upon re-export. They have stated that upfront payment of 5% IGST would constitute a substantial strain.**

4. GMB have requested for exemption from payment of 5% IGST in cash and as a solution suggested the IGST amount of 5% could be secured by way of inclusion in the bond amount backed by guarantee.

5. ONGC have stated that they have entered into an agreement with M/s Canyon Offshore Limited for hiring a vessel with its equipment, operational personnel etc for a service value of US \$5,460,000. ONGC have also stated that the BCD on the said vessel and equipment when imported into India is nil. **However, 5% IGST is payable on import of vessel.**

6. ONGC further stated that 5% IGST on the value of vessel and its equipment works out to US\$5,976,302/- and contended that the tax component on an equipment cannot be more than the total service value for use of the vessel on hire for 15 days.

### EXAMINATION

7. Both the requests from GMB and ONGC respectively have been examined. The case of import of vessel by GMB on lease basis is similar to that of ONGC. In terms of notification No. 27/2002-Cus as amended a graded duty structure is provided for goods imported temporarily. **The duty structure is 5%, 15%, 25%, 30%, 35% & 40% of the aggregate duties of customs** depending upon whether the goods are re-exported within 3, 6, 9, 12, 15 and 18 months respectively. Since IGST is a new levy, therefore, the benefit of above percentage rates does not cover IGST. Thus, IGST 5% rate is to be paid over and above the applicable rate of the **aggregate duties of customs**. **It may also be added that while IGST could be refunded at the time of export, the quantum of customs duty paid under this notification cannot be refunded by way of drawback.**

8. In addition to the above, there is also the liability to pay IGST at the appropriate rate as import of service also. This is because import of goods on lease basis is treated as a service under the CGST Act. Neither GMB nor ONGC have factored this in their representation. **Thus, all cases of import of goods on lease basis shall have to bear IGST as import of goods and IGST as import of service.** It is likely that we may have more representations in the coming days on this issue.

#### **PROPOSAL FOR GST COUNCIL**

9. This double levy would be an aberration unless it is a conscious decision of the Government/ GST council.

10. It is proposed to exempt the IGST leviable under Section 3(7) of Customs Tariff Act on temporary import of machinery, equipment or tools falling under any chapter of First schedule of the Customs Tariff Act subject to the following conditions:

- a. The import of such machinery, equipment or tools is covered under item (b) of clause 1 and item (f) of clause 5 of Schedule II of CGST Act, 2017; and
- b. IGST is paid at the appropriate rate on such supply of machinery, equipment or tools as import of service.