

ONE HUNDRED FIFTY EIGHTH REPORT

OF

LAW COMMISSION OF INDIA

ON

THE AMENDMENT OF

THE INDUSTRIES (DEVELOPMENT & REGULATION)

ACT, 1951

JUNE, 1998

JUSTICE
B. P. JEEVAN REDDY
Chairman, Law Commission of India



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D.O.No.6(3)(47)/98-LC(LS)

Dated 1st June, 1998

Dear Minister,

I am forwarding herewith the One Hundred and Fifty Eighth Report of the Law Commission of India on "The Amendment of the Industries (Development & Regulation) Act, 1951".

2. The subject was taken up by the Law Commission on its own. The need for taking up the subject is on account of the emerging of several practical problems as a sequel to the decision of the Constitution Bench of the Supreme Court in the case of Synthetics and Chemicals Ltd. and others Vs. State of U.P. and others, (1990)1 SCC 109, as discussed in Chapter II of the Report. The import of the said Synthetics case decision has caused inconsistency in later Supreme Court decisions, discussed in Chapter II of the Report.

3. This Report seeks to do away with the doubts so that the conflicts in the discharge of functions of the Central and State Governments pertaining to the subject are reconciled as soon as possible.

With regards,

Yours sincerely,

(B.P. JEEVAN REDDY)

Dr. M. Thambi Durai,
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CHAPTER I

INTRODUCTION

1.1 The Scope:

The Law Commission of India has taken up, suo motu, for consideration the amendment of Item 26 in the First Schedule to the Industries (Development & Regulation) Act, 1951 in view of, and with a view to remove the difficulties expressed by the Supreme Court in its various decisions discussed in this Report (Chapter II, infra) in interpreting the Constitutional provisions pertaining to the subject.

In a recent decision of the Supreme Court in Coir Board Vs. Indira Devi P.S., 1998 (2) SCALE 195, Prs 20 & 21, the Court noticed the uncertainty prevailing in interpretation of the term 'industry' in Industrial

Disputes Act, 1947 despite the decision of the majority of five Judges Bench decision in Bangalore Water Supply and Sewerage Board vs. A. Rajappa, (1978) 2 SCC 213), and observed:-

"21. Undoubtedly, it is of paramount importance that a proper law is framed to promote the welfare of labour employed in industries".

In Murari Lal Mahavir Prasad v. B.R.Vad, (1975) 2 SCC 736 it was observed:-

"if the statute contains a lacuna or a loophole, it is not the function of the Court to plug it by a strained construction in reference to the supposed intention of the legislature. The legislature must then step in to resolve the ambiguity and so long as it does not do so the tax payer will get the benefit of that ambiguity; but equally the court ought not to be astute to hunt out ambiguities by an unnatural construction of a taxing section."

A duty is enjoined upon the legislature to frame the appropriate law when the issue becomes complex and thorny and is frequently raised in the courts (see para 2.2.4,

infra) and above all there are inconsistencies in the Supreme Court decisions on the subject (see para 2.2.5, infra).

The Law Commission is also of the opinion that since clarity and certainty of law has been lacking on the subject dealt with in this report, grave doubts arising in the judicial battlefield, should be removed legislatively, in view of the colossal amount of revenue and manifold activities involved in it viz., power to legislate on liquors, that is to say, production, manufacture, processing, transport, purchase and sale thereof, and licensing, control of supply, distribution, price, fees, duties, etc.

1.2 The Background:-

The object behind the enactment of the Industries (Development & Regulation), Act, 1951 is to provide the Central Government with the means of implementing their industrial policy which was announced in their Resolution No.1(3)-44(13) 48 dated 6th April, 1948 and approved by the Central legislature. The Act brings under Central control the development and regulation of a number of important industries the activities of which affect the country as a whole and the development of which must be

governed by economic factors of all-India import. The planning of future development on sound and balanced lines is sought to be secured by the licensing of all new undertakings by the Central Government. The Act confers on Government power to make rules for the registration of undertakings and for regulating the production and development of the industries specified in the schedule. The Act also provides for the constitution of a Central Advisory Council, prior consultation with which will be obligatory before the Central Government takes certain measures such as the revocation of a licence or taking over the control and management of any industrial concern (Refer to the statement of Objects and Reasons of the Bill concerning the Act cited in the AIR Manual, vol. 30, page 891, 5th Edn.).

The Act was amended by the Amending Act 72 of 1971; Amending Act 67 of 1973; Act 4 of 1984; Section 2 of the Industries (Development & Regulation) Act, 1951 declares that it is expedient in the public interest that the Union should take under its control the industries specified in the First Schedule. Chapter II of the Act provides for establishment of Central Advisory Council and Development Councils. Chapter III deals with regulation of scheduled industries. Section 10 requires registration of existing industrial undertakings.

Section 10A empowers the Central Government to revoke registration in certain cases. Section 11 deals with the licensing of new industrial undertakings. Section 11A is concerned with the requirement of a licence for producing or manufacturing new articles by the owner. Section 11B empowers the Central Government to specify the requirements which shall be complied with by small scale industrial undertakings. Section 12 deals with the revocation and amendment of licences in certain cases. Section 14 deals with the procedure for the grant of licences or permission. Section 15 confers power of investigation to be made into scheduled industries or industrial undertakings. Section 15A empowers Central Government to investigate into the affairs of a company in liquidation. Under Section 16 the Central Government is empowered to carry out action as is desirable on completion of the investigation under section 15. Further Chapter IIIA deals with the direct management of control of industrial undertakings by Central Government in certain cases. Chapter III-AA deals with the management of control of industrial undertakings owned by companies in liquidation. Chapter III-AB confers power on the Central Government to provide relief to certain industrial undertakings. Chapter III-AC is concerned with the liquidation or reconstruction of companies. Chapter III-B of the Act contains Section 18-G whereby

the Central Government is empowered to control the supply, distribution and price etc. of certain articles, for securing equitable distribution and availability at fair prices of any article or class of articles relatable to any scheduled industry.

1.3 Relevant Constitutional Provisions concerning the subject under consideration:-

The subject of 'industries' is assigned to the States under Article 246 read with the Seventh Schedule to the Constitution of India. It is, however, made subject to certain Entries in the Union List. 'Entry 24' in List II (State List) reads: "industries subject to the provisions of Entries 7 and 52 of List I".

Entries 7 and 52 of List I (Union List) read as follows:-

7. Industries declared by Parliament by law to be necessary for the purpose of defence 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 the public interest."

It would be appropriate to set out Entry 33 of List III (Concurrent List) at this stage in view of its relevance to the subject considered herein. In so far as it is relevant, the Entry reads:-

"33. Trade and Commerce in, and the production, supply and distribution of - (a) the products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest, and imported goods of the same kind as such products;....."

1.3.2 Effect of enactment of Industries (Development & Regulation Act, 1951 upon the powers of the State Governments:-

By virtue of the Constitution of India which came into effect from January 26, 1950, the powers of legislation in respect of alcohol were distributed between List I and List II of the Seventh Schedule to the Constitution. Duties of excise on tobacco and other goods manufactured or produced in India except, inter alia, alcoholic liquors for human consumption, and opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any assistance included in sub-paragraph (b) of this entry, were given to Parliament under Entry 84, List I. But duties of excise on goods manufactured or

produced in the State and countervailing duties at the similar rates, inter alia, alcoholic liquors, the State was given power by Entry 51 of List II to legislate. By Entry 8 of List II, the States were given power to legislate on liquors, that is to say production, manufacture, processing, transport, purchase and sale thereof.

The entries in the three lists of the Seventh Schedule to the Constitution of India are legislative heads or fields of legislation. These demarcate the area over which appropriate legislation can operate. These neither impose any implied restriction on the legislative power conferred by Article 246 of the Constitution, nor prescribe any duty to exercise that legislative power in any particular manner. Hence the language of the entries should be given the widest scope, "to find out which of the meaning is fairly capable because these set up machinery of the Government." Each general word should be held to extend to all ancillary or subsidiary matters which can fairly and reasonably be comprehended in it. In interpreting an entry it would not be reasonable to import any limitation by comparing or contrasting that entry with any other one in the same list. It is in this

background that one has to examine the present controversy. (India Cement Ltd. and others vs. State of Tamil Nadu and others, 1990 (1) SCC 12, para 18).

Legislative power normally includes all incidental and subsidiary powers, except the power to tax which is neither incidental nor subsidiary to the power to legislate on a matter or a topic (M.P.V. Sundararamier & Co. vs. State of Andhra Pradesh (1958) SCR 1422 referred in State of Mysore vs. M/s D. Cawasji & Co., (1971) 2 SCR 799.

1.3.3 On or about May 8, 1952, Parliament enacted the Industries (Development and Regulation) Act, 1951 (IDR Act) declaring in terms of Entry 52 of List I, that the control by Parliament of the industries specified in the First Schedule to the said Act is expedient in public interest. The result of this declaration read with the First Schedule to the said Act was, that the States were denuded of their power to legislate conferred upon them by Entry 24 of List II to the extent of industries specified in the First Schedule to the IDR Act.

1.3.4 In the year 1956 the First Schedule to the IDR Act, was amended including some more industries therein. Item 26 which was one of the industries so added, reads:-

" 26. Fermentation Industries: (i) alcohol; (ii) other products of fermentation industries".

Therefore, by way of insertion of Item 26 in the First Schedule to the said Act, the Central Government was empowered to control the Fermentation Industries including alcohol industries.

1.3.5 Magnitude of use of alcohol and all pervasive control of State Governments prior to the commencement of the Constitution of India:-

There are several industries located all over the country manufacturing alcohol. Alcohol is also known by the name 'rectified spirit'. Alcohol has manifold uses. It is used for obtaining alcohol - all that one has to do is to add water to reduce its power. It is used for manufacture of Indian-made foreign liquors like whisky, brandy, rum, gin, etc. Alcohol is also used in several other industries. Until a few decades ago and even today in certain States like Uttar Pradesh, alcohol is used mainly for the purpose of obtaining country liquor therefrom and for manufacture of Indian-made foreign

liquors, which together may be referred to hereinafter as 'intoxicating liquors' or as 'alcoholic liquors for human consumption'.

Almost every State in the country has an Excise Law in force - some of them enacted prior to the commencement of the Constitution - governing the manufacture, distribution, sale and possession of liquor. The definition of 'liquor' in these enactments made no distinction between liquor used for human consumption and liquor used for other purposes. These Acts purported to regulate all liquors. The Excise Duty on the manufacture of liquors was collected by the State Governments which also closely regulated and controlled the manufacture, possession, sale and transportation of these liquors. As a fact - and speaking generally - the Union Government had no say in the matter.

CHAPTER II

THE EMERGING OF SEVERAL PRACTICAL PROBLEMS AS A SEQUEL TO THE DECISION OF THE CONSTITUTION BENCH

2.1 Browsing of the Problem:-

The State of U.P. levied, inter alia, a fee called 'Vend Fee' on the sale of liquor manufactured in that State. The rule imposing Vend Fee made no distinction between the liquor sold for obtaining country liquor or for manufacturing liquors for human consumption or liquors sold to industries (other than those engaged in the manufacture of liquors for human consumption). A company called Synthetics and Chemicals Limited (Synthetics) filed a writ petition in the Allahabad High Court challenging the levy of Vend Fee on the liquors sold for industrial purposes. Its contention was that by virtue of Item 26 of the First Schedule to the IDR Act, the State of U.P. is not competent (after 1956) to levy any duty, tax or fee on denatured spirit, which it was dealing in. (Denatured spirit by its very nature is liquor rendered unfit for human consumption). Its contention was that Parliament alone is entitled to make any law and levy any duty, tax or fee on the denatured spirit. The writ petition was dismissed by the High

Court holding that expression "intoxicating liquors" occurring in Entry 8 of List II of the Seventh Schedule to the Constitution included within its ambit denatured spirit as a whole and, therefore, the State was perfectly competent to levy the impugned fee. Synthetics carried the matter in appeal to the Supreme Court which was dismissed in the year 1980. The decision is reported in (1980) 2 SCC 441 [= (1980) 2 SCR 531]. The Supreme Court referred to the history of State Excise Laws in this country and to the wide definition of liquor in these enactments and observed that while enacting the Government of India Act, 1935, the British Parliament must have been aware and must be deemed to have accepted the said wide definition. (It may be mentioned that the relevant Entries in the Seventh Schedule to the Government of India Act, 1935 and in the Seventh Schedule to the Constitution are identical). The Supreme Court held as follows:-

"11..... Dealing with the meaning of word 'liquor', the Court referred to the various Abkari cases in several provinces and found that all the Provincial Acts of this country have consistently included liquor containing alcohol in the definition of 'liquor' and 'intoxicating liquor' and, therefore, the framers of the

Government of India Act, 1935 could not have been entirely ignorant of the accepted sense in which the word 'liquor' has been used in the various excise Acts of this country and concluded that the word 'liquor' covers not only those alcoholic liquids which are generally used for beverage purposes and produce intoxication, but also all liquids containing alcohol.... In the context it is clear that the decisions proceeded on the basis that the word 'intoxicating liquor' is not confined to potable liquor alone but would include all liquor which contain alcohol."

Synthetics, however, was not satisfied with the judgment. It filed a review petition in the Supreme Court which remained pending for quite some time. Meanwhile, several other writ petitions were filed in the Supreme Court raising the very same contention. All these matters including the review petition filed by Synthetics were referred to a larger Constitution Bench of seven-Judges which rendered its judgment on 25.10.1989 (reported in (1990) 1 SCC 109 [= (1989) Supp. 1 SCR 623]). The Constitution Bench held that the expression "intoxicating liquors" occurring in Entry 8 of List II means and refers only to potable liquors i.e., liquors fit for human consumption and that potability is determined by the

standards specified by the Indian Standards Institute viz., the alcohol content should not exceed 43% v/v. Entry 51 of List II, it held, is also similarly limited to potable liquors. The Bench held that the power of the States to legislate in respect of liquors was restricted to potable liquors only. The Bench held further that "rectified spirit" - which expression was used interchangeably with the expression "ethyl alcohol" and "industrial alcohol" - is of 95% and above purity and cannot, therefore, be treated as potable liquor. It held that rectified spirit falls exclusively within the power of the Union by virtue of the IDR Act. The Bench observed that after the 1956 amendment to the IDR Act bringing alcohol industries (under fermentation industries) as Item 26 of the First Schedule to the IDR Act, the control of this industry has vested exclusively in the Union. It thus held as follows:-

"85. After the 1956 amendment to the IDR Act bringing alcohol industries (under fermentation industries) as Item 26 in the First Schedule to IDR Act the control of this industry has vested exclusively in the Union. Thereafter, licences to manufacture both potable and non-potable alcohol is vested in the Central Government. Distilleries are manufacturing alcohol under the

Central licences under IDR Act. No privilege for manufacture even if one existed, has been transferred to the distilleries by the State. The State cannot itself manufacture industrial alcohol without the permission of the Central Government. The States cannot claim to pass a right which they do not possess. Nor can the States claim exclusive right to produce and manufacture industrial alcohol which are manufactured under the grant of licence from the Central Government. Industrial alcohol cannot upon coming into existence under such grant be amenable to States' claim of exclusive possession of privilege. The State can neither rely on Entry 8 of List II nor Entry 33 of List III as a basis for such a claim. The State cannot claim that under Entry 33 of List III, it can regulate industrial alcohol as a product of the scheduled industry, because the Union, under Section 18-G of the IDR Act, has evinced clear intention to occupy the whole field. Even otherwise sections like Sections 24-A and 24-B of the U.P. Act do not constitute any regulation in respect of the industrial alcohol as product of the scheduled industry. On the contrary, these purport to deal with the so-called transfer of privilege

regarding manufacturing and sale. This power, admittedly, has been exercised by the State purporting to act under Entry 8 of List II and not under Entry 33 of List III.

86. The position with regard to the control of alcohol industry has undergone material and significant change after the 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 (AIR 1971 SC 1182).

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88. On an analysis of the aforesaid decisions and practice, we are clearly of the opinion that in respect of industrial alcohol the States are not authorised to impose the impost they have purported to do. In that view of the matter, the contentions of the petitioners must succeed and such impositions and imposts must go as being invalid in law so far as industrial alcohol is concerned. We make it clear that this will not affect any impost so far as potable alcohol as commonly understood is concerned. It will also not affect any imposition of levy on industrial alcohol fee where there are circumstances to establish that there was quid pro quo for the fee sought to be imposed. This will not affect any regulating measure as such."

2.2.1 Nature of problems created in pursuance to the decision in Synthetics & Chemicals Ltd. case (supra)

The decision of the Constitution Bench created several practical problems. As is explained in the later decisions of the Supreme Court, to be referred to presently, there is no such thing as "industrial alcohol". What is manufactured is alcohol, namely, of 95% and above purity which, it appears, is known as "ethyl alcohol" and also as 'rectified spirit'. This rectified spirit can be used for both industrial and non-industrial purposes. (In the following paragraphs wherever reference is made to "industrial" purposes, it means purposes of industries other than those engaged in the manufacture of intoxicating liquors/IMFL and wherever the expression 'non-industrial' purpose is used, it means the use of alcohol for obtaining country liquor/arrack by mixing water therein or by industries engaged in manufacture of intoxicating liquors/IMFL). Rectified spirit can be used both for industrial purposes and non-industrial purposes. What is very often done and insisted upon by the State governments is to denature the rectified spirit meant for industrial purposes. This is done because once the rectified spirit/alcohol is

denatured by adding denaturants, the alcohol/rectified spirit becomes unfit for obtaining country liquor or for manufacturing intoxicating liquors/IMFL. It can be used only for industrial purposes like manufacture of paints, varnishes and other industrial purposes. But what is important to notice to repeat - is that even without mixing denaturants, rectified spirit/alcohol can be used for industrial purposes. Now, a plant producing alcohol/rectified spirit may remove it (according to the Central Excise and Salt Act, 1944 and the Rules made thereunder, it may be remembered, duty is payable at the stage of "removal". Though the duty of excise is leviable and levied on the manufacture or production of the goods, it is collected at the stage of removal from the place of production or the bonded warehouse, as the case may be. This position is well established by the several decisions of the Federal Court and the Supreme Court) and sell it either for industrial purposes or for non-industrial purposes as may be directed by the appropriate regulating authority. There are also units which manufacture rectified spirit for their own consumption i.e., for manufacturing intoxicating liquors/IMFL. The difficulty, however, arises (particularly in view of the indisputable fact that for obtaining the country liquor/arrack, all one has to do is to mix water with the rectified spirit) in the matter not

only of levy of duty, tax and fees but more so in the matter of regulating and controlling the manufacture, possession, sale and transportation of the rectified spirit which is not denatured. According to the aforesaid judgment of the Constitution Bench, as interpreted and understood by one section of lawyers, States have no power either to levy any duty/tax/fees on the rectified spirit or to regulate its manufacture, possession, sale or transport it being the exclusive domain of the Union - and that they come in only when the potable liquors including country liquor is manufactured or obtained, as the case may be. The other interpretation and understanding of the aforesaid decision of the Constitution Bench is that the said decision is confined only to industrial alcohol i.e., denatured spirit or the denatured rectified spirit, as the case may be, and is not relevant to non-denatured spirits and that so far as non-denatured alcohol/rectified spirit is concerned, the States alone have the exclusive power to levy duty, tax and fee thereon and to regulate their manufacture, possession, sale and transportation.

2.2.2 The horizon of the decision in Synthetics case (supra) considered by the Supreme Court:-

In a judgment of Allahabad High Court rendered on 9.9.91 in Vam Organic Chemicals Ltd. v. State of U.P., in C.M.W.P. No.16782 of 1990, the latter view (second of the two views mentioned above) was affirmed. This judgment has been approved in its totality by the Supreme Court in Vam Organic Chemicals Ltd v. State of U.P. (1997) 2 SCC 715. This was a case, where the Govt. of U.P. made a rule requiring the distilleries in the State holding PD2 and persons holding FL 16, 39, 40, 41 or PD2 to obtain a new licence from the Collector and pay a denaturation fee of Rs.7/- per litre in advance. This rule and the said levy was challenged by the petitioner-distillery on the ground that the State of U.P. was not competent to make any rule or levy any fees on the denaturing of alcohol. In other words, their contention, based upon Synthetics, was that the State has no power to make any law respecting alcohol and industrial alcohol or to levy any fees/tax thereon. This contention was rejected both by the High Court and the Supreme Court. Before, however, setting out the grounds on which the power of the State was upheld, it is necessary to notice the following opening observations in the judgment rendered by A.M. Ahmadi, C.J. on behalf of Bench:

" Before proceeding further, it will be proper to understand the difference between industrial alcohol, denatured spirit and potable liquor. Ethyl alcohol is rectified spirit of 95% v/v in strength. Rectified spirit is highly toxic and unfit for human consumption. However, rectified spirit diluted with water is country liquor. Rectified spirit, as it is, can be used for manufacture of various other products like chemicals etc. Rectified spirit, produced for industrial use is required by a notification issued under the Act to be denatured in order to prevent the spirit from being directed to human consumption. Rectified spirit is denatured by adding denaturants which make the spirit unpalatable and nauseating. As such rectified spirit can be converted to potable liquor but once denatured, it can be used only as industrial alcohol."

Now coming to the grounds on which the power of the State to make the impugned Rule and to levy the impugned fee was upheld, they are the following, in the words of the Bench itself:-

- (a) "Thus, the power under Section 18-G can be exercised only so far as is permitted by sub-section (1) viz. for securing the equitable distribution and availability at a fair price of any article or class of articles relatable to any scheduled industries. To this extent, the State Legislature can not make any law. The High Court concludes that in other respects the field is still open to the State Legislature. The High Court goes on to say that the impugned notification is issued to ensure that rectified spirit sought to be used for industrial purposes is not diverted for obtaining country liquor or other forms of potable liquor and that it is not concerned with equitable distribution and availability at a fair price of either rectified spirit or the denatured spirit. The notification was, thus, justified under Entry 6 of List II Public Health; and Entry 8 of List II - Possession and Sale of Intoxicating liquor".

(b) "This Court dealt with the question of legislative competence of the State to impose tax or levy on industrial alcohol in the case of Synthetics and Chemicals Ltd. v. State of U.P. and ruled in the negative. The High Court took the view that the distinction between ethyl alcohol/rectified spirit as such and denatured spirit was not in issue, nor was it considered in that judgment and held that this Court cannot be said to have ruled that every rectified spirit/ethyl alcohol is industrial alcohol. The High Court reiterated that once denatured, the alcohol becomes exclusively industrial alcohol since it cannot be used for obtaining country liquor or for manufacturing IMFLs and said that it is to ensure that ethyl alcohol meant for industrial use is not misused or diverted for human consumption that impugned regulation is provided for by the State and further that the regulation being part of general regulation of the trade in alcohol in the interest of public health is relatable to Entries 6 and 8 of List II."

(c) "It is to be noticed that the States under Entries 8 and 51 of List II read with Entry 84 of List I have exclusive privilege to legislate on intoxicating liquor and alcoholic liquor for human consumption. Hence, so long as any alcoholic preparation can be diverted to human consumption, the States shall have the power to legislate as also to impose taxes etc. In this view, denaturation of spirit is not only an obligation on the States but also within the competence of the States to enforce."

(d) The Bench also relied upon a recent decision of the Supreme Court in State of A.P. v McDowell ((1996) 3 SCC 709), and quoted the following holding therein with approval: -

"It follows from the above discussion that the power to make a law with respect to manufacture and production and its prohibition (among other matters mentioned in Entry 8 in List II) belongs exclusively to the State Legislatures. Item 26 in the First Schedule to the IDR Act must be read subject to Entry 8 - and for that matter, Entry 6 - in List II. So read, the said item does and cannot deal with manufacture, production of intoxicating liquors. All the petitioners before

us are engaged in the manufacture of intoxicating liquors. The State Legislature is, therefore, perfectly competent to make a law prohibiting their manufacture and production - in addition to their sale, consumption, possession and transport - with reference to Entries 8 and 6 in List II of the Seventh Schedule to the Constitution read with Article 47 thereof".

2.2.3 Import of Synthetics case decision (supra) again considered by the Supreme Court :-

The question of states' power in the matter of regulating the manufacture, possession, sale and transport and its power to impose prohibition came up directly for consideration before a three Judge Bench of the Supreme Court in State of A.P. v. McDowell & Co. ((1996) 3 SCC 709). The said judgment sought to explain the decision of the Constitution Bench in Synthetics. It was explained that Entry 52 over-rides Entry 24 alone and does not over-ride any other Entry in List II. Reliance was also placed on Entry 33 in List III which empowers both the Union and the States to make a law concerning "trade and commerce in, and the production, supply and distribution of the products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest, and imported goods of the same kind as such products". It was held that in so far as industries engaged in manufacture of intoxicating liquors are concerned, the States have the exclusive power to legislate. The other

part of this decision has already been set out in the preceding paragraph while setting out the grounds of the judgment in Vam Organics.

2.2.4 Emphasis on the problem being a thorny one, laid by the Supreme Court in Bihar Distillery case (infra) and the Court enunciated parameters:-

Another matter came up before the Supreme Court where a distillery situated in Bihar, which has been obtaining licences throughout under the Bihar Excise Act, sought to raise the contention - when the Bihar State Authorities proposed to cancel its licence for certain alleged violations - that the State has no power to do so because according to the decision in Synthetics, the power to grant and cancel the licence of industries engaged in the manufacture of alcohol vested exclusively in the Union. When this matter came up before the Supreme Court of India, it gave a notice to the Union of India and to all the State Governments under the following Order:

" 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 v. State of U.P. ((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. v. McDowell & Co. ((1996) 3 SCC 709) that so far as

the intoxicating liquors/potable liquors are concerned, it is the exclusive province of the States. But for manufacturing intoxicating 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 purpose 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 license 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 case 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."

2.2.4(a) In response to the notice so issued, the Union Government as well as a large number of State Governments appeared and filed their submissions. They were heard through their respective advocates and judgment rendered on 29.1.1997 - reported in Bihar Distillery and Ors v. Union of India & Ors (1997) 2 SCC 727. After discussing the earlier decisions of the Court and the several problems arising therefrom, the Court made the following observations and gave the following directions:-

" It is these and many other situations which have to be 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 drawn at the stage of clearance/removal

of the rectified spirit. Where the removal/clearance is for industrial purpose (other than the 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 the 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 IDR 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, is 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 a reasonable regulatory fees to defray the costs of such staff, as held by this Court in Shri Bilelshwar Khand Udyog Khedut Sahakari Mandali Ltd v. State of Gujarat ((1992) 2 SCC 42) and Gujchem Distillers India Ltd. v. State of Gujarat ((1992) 2 SCC 399).

(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 Government, 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 State Government concerned. 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 State concerned 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 utilised for potable purposes, i.e., for obtaining or manufacturing potable liquors

shall be supplied to and/or utilised, as the case may be, in accordance with the State excise enactment concerned 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 IDR 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 utilised 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 IMFLs, 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 intoxicating liquors is equally that of the States, as held in McDowell ((1996) 3 SCC 709).

The writ petition is disposed of with the above directions."

2.2.5 Inconsistency in Supreme Court decisions on the subject pointed out by the Supreme Court in Haryana Brewery Ltd. case (infra):-

Another matter in C.A. 1999 & 2000/1997 (Government of Haryana v. Haryana Brewery), cited in ((1997) 5 SCC 758), came up before the Court wherein the industry engaged in the manufacture of alcohol relied upon a three-Judge Bench decision of the Supreme Court in State of U.P. v. Modi Distillery [1995 (6) JT 523] and a two-Judge Bench decision in Mohan Meakin Ltd. v. Excise and Taxation Commissioner, H.P. [1996 (9) SCALE 162] in support of their contention that States do not come into the picture until alcohol attains potability. Since it appeared that there was a certain inconsistency between the principles underlying the decision in Bihar Distillery and Vam Organics and the aforesaid decisions in Haryana Distillery and M/s Modi Distillery, the matter has been referred to the Constitution Bench to pronounce authoritatively upon the situation arising from the several decisions of the Supreme Court which do not necessarily speak in one voice. The order of reference dated 11th March, 1997 reads as follows:-

"Certain important questions arise in these matters which, in our opinion, require to be decided authoritatively by a Constitution Bench. Much water has flowed since the decision of the seven Judge Constitution Bench of this Court in Synthetics and Chemicals Ltd. v. State of Uttar Pradesh [1990 (1) SCC 109]. In State of Andhra Pradesh v. McDowell [1996 (3) JT (SC) 679], it has been held by a three-Judge Bench of this court that so far as intoxicating liquors are concerned, their production, manufacture, possession, transport, purchase and sale is the

exclusive province of the States by virtue of Entry 8 of List-II. It has also been held that the imposition of prohibition and levy of duties thereon is also the prerogative of the States alone. In Vam Organic & Chemicals Ltd. v. State of Uttar Pradesh [1997 (1) JT (SC) 625], it has been held by a two-Judge Bench of this Court that the decision in Synthetics and Chemicals was concerned only with industrial alcohol and that so long as any alcoholic preparation can be diverted to human consumption, the States have the power to legislate in that behalf and also to impose taxes. It has been held that rectified spirit can be converted into country liquor by mere addition of water and, therefore, the States are not totally excluded from control over the rectified spirit. In Bihar Distillery v. Union of India (1997)2 SCC 727, it has been held by another Bench of two Judges that having regard to the fact that by merely adding water, rectified spirit can be converted into country liquor and also because rectified spirit can also be used for manufacturing IMFLs, the States are entitled to joint control over production, storage and distribution of rectified spirit. It has been held that so far as levy of duties are concerned, the point of departure is the stage of removal. The rectified spirit which is removed for industrial purposes [purposes other than manufacture of IMFLs or country liquor] can be taxed by the Union while the rectified spirit which is removed for the purpose of manufacture of IMFL or country liquor or other intoxicating liquors can be taxed by the States.

In State of Uttar Pradesh & others v. Modi Distillery [1995 (6) JT (SC) 523], a three Judge Bench of this court held that any wastage occurring in the course of manufacture of alcoholic liquors occurring before it reaches the stage of alcoholic liquor for human consumption is outside the State's jurisdiction but any wastage occurring after they reach the alcoholic liquor for human consumption is the province of the State. This was held in the context of power to levy duty upon liquors. To the same effect is the decision of a two Judge Bench in Mohan Meakins Ltd. v. Excise & Taxation Commissioner, Himachal Pradesh & others. [1996 (9) SCALE 162].

We are of the opinion that the legislative power conferred upon the States by the Constitution and recognised even in Synthetics & Chemicals should include all incidental and ancillary powers and it is this aspect which was emphasised in Bihar Distillery. Any principle enunciated with respect to the respective powers of the Union and the States should be practical and realistic and such as not to give room for abuse or misuse. Since the decisions aforementioned project different points of view, it is necessary to evolve a coherent and effective formula so that the Union and the State should know what are their respective powers and jurisdiction.

The papers may accordingly be placed before Hon'ble the Chief Justice for orders regarding placing these matters before the Constitution Bench".

CHAPTER III

THE NEED FOR AMENDING ITEM 26, FIRST SCHEDULE OF THE IDR ACT, 1951

3.1 Having observed in the preceding chapter, the apparent conflict in the Supreme Court decisions on the import of the important subject relating to item 26 of the First Schedule to the IDR Act, 1951, it is quint essential to do away with the doubts as early as possible so that the conflicts in the discharge of functions of the Central and State Governments are reconciled as held in M/s Murari Lal Mahavir Parsad v. B.R.Vad (1975) 2 SCC 736 quoted under para 1.1 supra.

3.2 Before embarking upon the effort to seek a solution to the problem, it is pertinent to refer to arguments advanced by the State Governments in Bihar Distillery case (supra) as follows:-

During the hearing of the case in Bihar Distillery, all the States uniformly contended that rectified spirit is "intoxicating liquor" within the meaning of Entry 8 of List II, that the decision in Synthetics is confined to industrial denaturant alcohol only and that if it is understood as applying to

non-denatured alcohol too, the decision requires reconsideration. They pleaded for exclusive control over alcohol viz., for the position obtaining before the Synthetics judgment. The following extracts from the judgment bear out the strength and justification behind the submissions made by the State Governments of West Bengal, Uttar Pradesh, Bihar, Karnataka, Maharashtra, Tamil Nadu, Andhra Pradesh, Kerala, Goa, Orissa and Himachal Pradesh.

"6. Accordingly, notices have been issued to all the State Governments. We have directed notice to learned Attorney General as well. We have heard Shri Bimal Kumar Sinha, learned counsel for the writ petitioner, Shri Shanti Bhushan for the State of West Bengal, Shri Rakesh Dwivedi, Additional Advocate General for the State of Uttar Pradesh for Uttar Pradesh and Bihar, Shri Santosh Hegde for the State of Karnataka, Shri M.S. Nargolkar for the State of Maharashtra, Shri V. Krishnamurthi for the State of Tamil Nadu, Shri K. Ram Kumar for the State of Andhra Pradesh, Shri G. Prakash for the State of Kerala, Ms Subhashini for the State of Goa, Shri P. N. Misra for the state of Orissa and Shri T. Sridharan for the State of Himachal Pradesh. Shri M.S. Usgaocar, learned Additional Solicitor General appeared for the Union of India. We also requested Shri Harish N. Salve, who was appearing in the connected matter [Special Leave Petition (C) No. 9863 of 1996 - involving inter alia the question at issue herein] to address us on the general question which he has agreed gracefully to do.

"13. The several State Governments, to whom notices have been given, have responded. Some of them have filed very elaborate counters setting out their case. The first and foremost contention urged on their behalf is that rectified spirit is "intoxicating liquor" within

the meaning of Entry 8 of List II. In other words, their contention, based upon the ratio in McDowell, is that rectified spirit is "intoxicating liquor" within the meaning of Entry 8 of List II, and hence, outside the purview of Entry 24 of List II, which in turn means that the Union cannot take over its control by making a declaration in terms of Entry 52 of List and further that item 26 of the Schedule to IDR Act is ineffective and invalid in so far as it seeks to regulate the production, manufacture et al of rectified spirit. In support of their submission, they have relied upon the legislative history of the several State enactments in India apart from a wealth of material including technical data. They submit that the decision to the contrary in Synthetics is not correct and requires reconsideration. They have also assigned several reasons why the holding in Synthetics insofar as the meaning of "intoxicating liquor" is concerned should be held to be obiter. They submitted that in the interests of maintaining the balance between the Centre and the States and to preserve the federal nature of our Constitution - which is one of its basic features - the matter must be referred to a larger Bench to consider the correctness of Synthetics. They submitted that the relevant words in Entry 51 of List II and Entry 84 of List I are "alcohol liquors for human consumption" and not "alcoholic liquors fit for human consumption." They complained with a good amount of emotion that the decision in Synthetics reads the word "fit" into the said entries and makes it a basis for curtailing the legislative power of the States. There is no warrant for such addition, they submitted. In addition to the above submissions, the following facts are stated in the affidavit filed on behalf of the State of Uttar Pradesh: the reduction process of converting rectified spirit into country liquor involves mixing of water and stirring. By adding water, the alcoholic content is reduced to 35% v/v to make it country liquor. Adding of spices is optional. Rule 45 of the Uttar Pradesh Excise Rules defines the expression "reduction of liquor". According to the definition, it means "the reduction of liquor from a higher to a lower strength by the addition of water". Mere mixing of water, it is submitted, makes rectified spirit country liquor. On this basis too, it is submitted, rectified spirit is really and

essentially an intoxicating liquor and merely because water is required to be added to make it country liquor, it does not cease to be intoxicating liquor. By way of analogy, it is submitted that even the whiskies and brandies are not ordinarily consumed as such but only after mixing water or soda. Addition of water or soda, it is submitted, does not change the character of whisky or brandy either. It is next submitted that bulk of rectified spirit manufactured in Uttar Pradesh is used for the purpose of obtaining country liquor or IMFLs. Only a small quantity is used for industrial purposes. Having regard to the predominant use to which rectified spirit is put, it is submitted, it must be understood as intoxicating liquor. The adding of denaturants is only with a view to ensure that the rectified spirit is not used for potable purposes. Yet another submission put forward by the State of Uttar Pradesh is that even during the course of manufacture of rectified spirit, potable liquor comes into existence. It is submitted that the main raw material for rectified spirit is molasses. The process of manufacture is elaborately set out, supported by technical literature. The samples taken from certain distilleries by the excise staff and the result of the analysis of the said samples is also relied upon. It is submitted that the process of manufacture of rectified spirit involves increasing the alcoholic content by repeatedly processing it. The alcoholic content keeps on rising from stage to stage. It is submitted that at several intermediary stages, the liquor can be taken out and used for drinking purposes, whether as it is or after mixing water, as the case may be. Shri Rakesh Dwivedi, learned Additional Advocate General for the State of Uttar Pradesh, placed strong reliance upon the reasoning and conclusions in the judgment of the Allahabad High Court in Vam Organic Chemicals Ltd. v. State of U.P., which, it is brought to our notice by written submissions, has since been affirmed by this Court in Vam Organic Chemicals Ltd. v. State of U.P. by a Bench consisting of the Hon'ble Chief Justice and Sen, J."

It may be remembered that these submissions were made as late as in 1996-97.

3.3 Consideration of the problem and recommendations:-

The Law Commission has considered the pros and cons of the problem including the import of various decisions cited in the report from various perspectives and also parameters envisaged in Bihar Distillery's case (cited in para 2.2.4 (supra). While construing the scope of provisions it is a well settled principle of construction that where alternative constructions are equally open that alternative is to be chosen which will be consistent with the smooth working of the system which the statute purports to be regulating; and that alternative is to be rejected which will introduce uncertainty, friction or confusion into the working of the system (Collector of Customs v. D. S&W Mills Ltd. AIR 1961 SC 1549 = (1962) 1 SCR 396). Besides one cannot ignore the fact that a duty is cast upon the State to protect the fundamental right of citizens under Article 21 read with Article 47 of the Constitution, i.e. the duty of the State to raise the level of nutrition and the standard of living and to improve the public health. The Sarkaria Commission on Centre-State relations in its

report (Part I) has also comprehensively dealt with the scope of the I.D.R. Act in the context of Union-State relations and recommended as follows:-

"12.11.01. If Union control of a specific aspect of an industry is considered expedient in the public interest, it would be advisable that the IDR Act is suitably amended to facilitate the Union Government's regulation of that aspect only. Parliament may have to pass a separate law under Entry 52 of List I..... If such new legislation presents any serious difficulty, an alternative may be to replace the present First Schedule of the IDR Act by several Schedules, each of such would specify the purpose for which a particular control was imposed on an industry so that all other areas of Entry 24 of List II remain unoccupied by the Union. The Planning Commission, in consultation with the Ministries of Industry and Law and Justice, should prepare a paper on this subject for the consideration of the NEDC at an early date.

12.11.02 As a mandatory legal requirement, there should be a periodical review, say, every three years, to determine whether in respect of any of

the industries the Union's control should be continued or relaxed or lifted. Such a review may be undertaken by a Committee of Experts on which the State Governments should be represented on a Zonal basis. The result of the review may also be placed before the NEDC."

Thus the Sarkaria Commission has also recommended that the Union control of a specific aspect of an industry which is considered expedient in the public interest, should be dealt with by the Centre by amending the IDR Act to facilitate the Union Government's regulation of that aspect only. Besides, the said Commission has emphasised the need for a mandatory legal requirement whereunder there should be a periodical review, say, every three years, to determine whether in respect of any of the industries the Union's control should be continued or relaxed or lifted.

In order to attain the smooth working of the system and to remove uncertainties, friction and confusion in the working of the system, as also to realise the constitutional objectives set out above, and above all by treading in the direction set out in the Sarkaria Commission's report quoted above to minimise the Union's control on a specific aspect of an industry,

instead of its all pervasive control of industries, we are of the view that there is urgent need to amend the IDR Act, 1951 in the manner set out below.

The Law Commission of India is of the opinion that the above matter should be clarified by enacting appropriate amendments to the IDR Act instead of leaving the matter to be fought out in Courts. This controversy has already attracted four or more judgments and the confusion has not been cleared. In the interests of maintaining balance between the Union and the States and also with a view to eliminate the room for abuse of law and misuse of alcohol, to enable the States to levy and collect the income which they were receiving by levying excise duties on alcohol for more than a century prior to the decision in Synthetics and also to put an end to the legal wrangling, it is eminently proper and expedient to substitute the following item as item 26 in the First Schedule to the IDR Act in the place of the existing item 26: "Fermentation Industries but not including alcohol". This would make the law, and more so its administration, clear, and unambiguous. It would also help the States to raise a little more revenue than at present and remove their grievance as expressed by them during the hearing of Bihar Distillery Case.

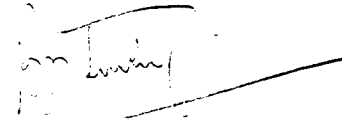
For removal of any doubts, it may be clarified that so far as the levy of excise duty is concerned, the position should be as indicated in the decision of the Supreme Court in Bihar Distillery viz., the alcohol 'removed' for purposes other than potable purposes (for obtaining arrack or for manufacturing alcoholic drinks) shall be subject to the central excise duty while the alcohol removed for potable purposes (for obtaining arrack or for manufacturing alcoholic drinks) shall be subject to the State excise duty and shall be levied and collected accordingly. Indeed, the collection of the central excise duty can be entrusted, if found advisable, to the State Excise officials, who will in turn make it over to the designated authorities of the Central Government.

CHAPTER IV

CONCLUSION

4.1 The Law Commission recommends for substituting the following item as Item 26 in the First Schedule to the Industries (Development and Regulation) Act, 1951 in the place of the existing Item 26 in the First Schedule thereto:-

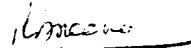
"Fermentation Industries but not including alcohol."



(B.P. Jeevan Reddy)

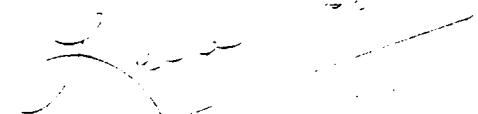
Dated: 20th May, 1998.

Chairman



(R.L. Meena)

Member-Secretary



(Leila Seth)

Member