

IN THE HIGH COURT OF KARNATAKA AT
BENGALURU

DATED THIS THE 18TH DAY OF FEBRUARY, 2016

BEFORE

THE HON'BLE MR. JUSTICE ANAND BYRAREDDY

WRIT PETITION No.12872 OF 2013 (T-IT)

CONNECTED WITH

WRIT PETITION No.14687 OF 2014 (T-IT),

WRIT PETITION No.15910 OF 2015 (T-IT),

AND WRIT PETITION No.17514 OF 2015 (T-IT)

IN W.P.No.12872 OF 2013

BETWEEN:

Karnataka State Beverages Corporation
Limited, represented by it's
Executive Director (Finance),
Sri. Shrikant B Vanahalli,
Aged about 57 years,
No.78, Seethalakshmi Towers,
Mission Road,
Bangalore 560 027.

...PETITIONER

(By Shri A. Shankar, Shri M. Lava and Shri S. Annamalai,
Advocates)

AND:

1. The Commissioner of Income-Tax,
Bangalore 560 001,
C.R.Building,
Queens Road,
Bangalore 560 001.
2. The Deputy Commissioner of Income-Tax,
Circle-11(5), R.P.Bhavan,
Opposite Reserve Bank of India,
Nrupathunga Road,
Bangalore 560 001.
3. State of Karnataka,
Through its Additional Chief Secretary to
Government of Karnataka,
Finance Department,
2nd Floor, Vidhana Soudha,
Bangalore 560 001.
4. The Commissioner of Excise,
Vokkaligara Bhavana,
K C R Circle,
Bangalore 560 001.

...RESPONDENTS

(By Shri Jeevan J Neeralgi, Advocate for Respondent Nos.
1 and 2;

Shri Madhusudhan R Naik, Advocate General for
Shri S.V.Giri Kumar, Additional Government Advocate for
Respondent Nos. 3 and 4)

This Writ Petition filed under Articles 226 and 227 of the
Constitution of India praying to declare that the disallowance of

privilege fees in the assessment order is in violation of the powers of the State to have its Statute as per Entry 8 of list-II of Seventh Schedule and being within its powers under Article 245(1) and 246(3) of the Constitution of India and etc;

IN W.P.No.14687 OF 2014

BETWEEN:

Karnataka State Beverages Corporation
Limited, represented by it's
Executive Director (Finance),
Sri. Shrikant B Vanahalli,
Aged about 58 years,
No.78, Seethalakshmi Towers,
Mission Road,
Bangalore 560 027.

...PETITIONER

(By Shri A. Shankar, Shri M. Lava and Shri S. Annamalai,
Advocates)

AND:

1. The Commissioner of Income-Tax,
Bangalore-I,
C.R.Building,
Queens Road,
Bangalore 560 001.
2. The Deputy Commissioner of Income-Tax,
Circle-11(5), R.P.Bhavan,
Opposite Reserve Bank of India,
Nrupathunga Road,

Bangalore 560 001.

3. State of Karnataka,
Through its Principal Secretary to
Government of Karnataka,
Finance Department,
2nd Floor, Vidhana Soudha,
Bangalore 560 001.
4. The Commissioner of Excise,
2nd Floor, TTMC A Block,
BMTC Complex,
K.H.Road, Shantinagar,
Bangalore 560 001.

...RESPONDENTS

(By Shri Jeevan J Neeralgi, Advocate for Respondent Nos. 1 and 2;
Shri Madhusudhan R Naik, Advocate General for
Shri S.V.Giri Kumar, Additional Government Advocate for
Respondent Nos. 3 and 4)

This Writ Petition filed under Articles 226 and 227 of the Constitution of India praying to declare that the disallowance of privilege fees in the assessment order is in violation of the powers of the State to have its Statute as per Entry 8 of list-II of Seventh Schedule and being within its powers under Article 245(1) and 246(3) of the Constitution of India and etc;

IN W.P.No.15910 OF 2015

BETWEEN:

Karnataka State Beverages Corporation

Limited, represented by it's
Executive Director (Finance),
Sri. Shrikant B Vanahalli,
Aged about 59 years,
4th Floor, TTMC Building "A" Block,
BMTC, Shanthinagar,
Bangalore 560 027.

...PETITIONER

(By Shri A. Shankar, Shri M. Lava and Shri S. Annamalai,
Advocates)

AND:

1. The Commissioner of Income-Tax,
Bangalore 560 004,
C.R.Building,
Queens Road,
Bangalore 560 001.
2. The Deputy Commissioner of Income-Tax,
Circle-4(1)(1), R.P.Bhavan,
Opposite Reserve Bank of India,
Nrupathunga Road,
Bangalore 560 001.
3. State of Karnataka,
Through its Principal Secretary to
Government of Karnataka,
Finance Department,
2nd Floor, Vidhana Soudha,
Bangalore 560 001.
4. The Commissioner of Excise,

2nd Floor, TTMC A Block,
 BMTC Complex,
 K.H.Road, Shantinagar,
 Bangalore 560 001.

...RESPONDENTS

(By Shri Jeevan J Neeralgi, Advocate for Respondent Nos. 1 and 2;

Shri Madhusudhan R Naik, Advocate General for Shri S.V.Giri Kumar, Additional Government Advocate for Respondent Nos. 3 and 4)

This Writ Petition filed under Articles 226 and 227 of the Constitution of India praying to declare that the disallowance of privilege fees in the assessment order is in violation of the powers of the State to have its Statute as per Entry 8 of list-II of Seventh Schedule and being within its powers under Article 245(1) and 246(3) of the Constitution of India and etc;

IN W.P.No.17514 OF 2015

BETWEEN:

Karnataka State Beverages Corporation
 Limited, represented by it's
 Executive Director (Finance),
 Sri. Shrikant B Vanahalli,
 Aged about 59 years,
 4th Floor, TTMC Building "A" Block,
 BMTC, Shanthinagar,
 Bangalore 560 027.

...PETITIONER

(By Shri A. Shankar, Shri M. Lava and Shri S. Annamalai,
 Advocates)

AND:

1. The Commissioner of Income-Tax,
Bangalore 560 004,
C.R.Building,
Queens Road,
Bangalore 560 001.
2. The Deputy Commissioner of Income-Tax,
Circle-4 (1)(1), R.P.Bhavan,
Opposite Reserve Bank of India,
Nrupathunga Road,
Bangalore 560 001.
3. State of Karnataka,
Through its Principal Secretary to
Government of Karnataka,
Finance Department,
2nd Floor, Vidhana Soudha,
Bangalore 560 001.
4. The Commissioner of Excise,
2nd Floor, TTMC A Block,
BMTC Complex, K.H.Road,
Shantinagar,
Bangalore 560 001.

...RESPONDENTS

(By Shri Jeevan J Neeralgi, Advocate for Respondent Nos.
1 and 2;

Shri Madhusudhan R Naik, Advocate General for
Shri S.V.Giri Kumar, Additional Government Advocate for
Respondent Nos. 3 and 4)

This Writ Petition filed under Articles 226 and 227 of the Constitution of India praying to declare that the disallowance of privilege fees in the assessment order is in violation of the powers of the State to have its Statute as per Entry 8 of list-II of Seventh Schedule and being within its powers under Article 245(1) and 246(3) of the Constitution of India and etc;

These Writ Petitions coming on for orders, this day, the court made the following.

ORDER

Heard the learned counsel Shri A. Shankar appearing for the petitioner, the learned Advocate General Shri Madhusudhan R. Naik appearing for Respondents 3 and 4 and Shri Jeevan J. Neeralagi appearing for Respondents 1 and 2. These petitions are all heard and disposed of by this common order, as they are by the same petitioner. However, the challenge is to assessment orders for different years, as is detailed hereunder.

2. The petitioner is a company, a Government of Karnataka Undertaking engaged in the business of canalization of liquor, beer and rectified spirit.

The Assessing Officer, within whose jurisdiction the Company operates, had passed an assessment order under Section 143(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act', for brevity) for the Assessment years 2010-11 and disallowed the Privilege Fee of Rs.570,14,37,000/- and made disallowance under Section 14-A of the Act in a sum of Rs.36,52,797/- on 27.02.2013.

The Assessing Officer had also passed an assessment order under Section 143(3) of the Act for the assessment year 2011-12 and disallowed the Privilege fee of Rs.695,14,70,000/- made disallowance under Section 14A of the Act in a sum of Rs.19,20,039/-, disallowance of provision for ex-gratia Rs.37,52,700/- and disallowance of expenditure on increase in share capital Rs.4,85,000/-, by order dated 26.02.2014.

Similarly, an assessment order was passed under Section 143(3) of the Act for the assessment year 2012-13 wherein the Assessing Officer had disallowed the privilege fee of Rs.829,41,58,944/- and made disallowance under Section 14-A

of the Act in a sum of Rs.60,30,758/-, by order dated 12.03.2015.

For the Assessment year 2009-10, an order under Section 143(3) read with Section 147 and 254 of the Act was passed as on 19.03.2015, disallowing the privilege fee of Rs.479,36,60,000/- and made disallowance under Section 14-A of the Act in a sum of Rs.41,28,225/- and provision for ex-gratia Rs.18,90,000/-.

The total disallowance of privilege fee is as follows:

Writ Petition Number	Assessment Year	Privilege Fee
12872/2013	2010-2011	Rs.570,14,37,000/-
14687/2014	2011-2012	Rs.695,14,70,000/-
15910/2015	2012-2013	Rs.829,41,58,944/-
17514/2015	2009-2010	Rs.479,36,60,000/-

The Assessing Officer has disallowed the Privilege fee on the following grounds namely:

i) The privilege fee paid is more than the surplus earned by the Company in the trade of liquor.

ii) The distribution of profits arising in the hands of 50 CL-11 Licence holders was taken over by the State Government undertaking, namely the petitioner.

iii) Privilege fee paid is nothing but the appropriation of income.

iv) The Government of Karnataka has taken away not only the profits earned by the assessee company in the name of the privilege fee but also the other income.

v) Company has to compute the profit, pay the taxes on it and only then the surplus, if any, can be appropriated.

vi) The Government of Karnataka has varied the Privilege fee every year and there is no fixed rate.

vii) The percentage of privilege fee is not known to the company in advance or at the beginning of the year and the

payments made by the company are against the provisions of the Companies Act, 1956, The Income-tax Act, 1961 and Accounting Standards.

viii) The Government order on levying the privilege fee is passed purposefully only at the fag end of the financial year.

ix) The petitioner - Company is parting with its taxable profits to the Government under the name of “privilege fee”.

x) Provisions of Section 40(a)(ii) would be applicable.

xi) The privilege fee does not satisfy the definition of “fee”, as all the elements of “tax” levied are missing.

xii) The payment of privilege fee is not an expenditure incurred towards earning of income.

xiii) Section 40(a)(iib) is held as clarificatory in nature.

Page No.88 of the order for the Assessment Year 2012-2013.

xiv) Amendment made in Section 24 of the Karnataka Excise Act, 1965 is illegal.

3. The learned counsel for the petitioner would contend that the several reasons assigned by the Assessing Officer in the Assessment orders pertaining to the above years would raise the following issues:

- i) Section 40(a)(iib) of the Income-tax Act disallows the privilege fee from the Assessment Year 2014-15 and subsequent years only and the amendment is prospective and not clarificatory.
- ii) The provisions of Section 40(a)(ii) are not applicable to the petitioner's case.
- iii) The payment of privilege fee is not appropriation or application of income and is allowable business expenditure.
- iv) Issues of amendment to the State Excise Act.
- v) Submissions on Alternative remedy.

Insofar as Section 40(a)(iib) is concerned, the learned counsel would submit that the said sub-clause was inserted by the Finance Act, 2013 with effect from 1.4.2014 and the said

section specifically disallows any amount paid by way of privilege fee or which is appropriated directly or indirectly from a State Government undertaking by a State Government. Consequently in view of the said provision, no disallowance can be made to the impugned assessment years 2009-2010, 2010-2011, 2011-2012 and 2012-2013, for the reason that the above provision is applicable only from the assessment year 2014-15 and subsequent years and it is applicable prospectively.

This is supported by the Memorandum explaining the provisions of the finance bill, Circular No.3/2014 dated 24.01.2014 and Note on clauses. It is also pointed out that the decision of the Supreme Court in the case of *CIT vs. Vatika Township (P) Ltd., (2014) 367 ITR 466 (SC)*, would support the case of the petitioner that from a plain reading of the said provision, it is clearly prospective.

Further, the learned counsel Shri Shankar would point out that the circular is binding on the Department and there is ample authority in this regard, namely:

a) Navnit Lal C. Javeri vs. K.K.Sen, AAC [1965] 56 ITR 198 (SC).

b) Ellerman Lines Limited vs. CIT, [1971] 82 ITD 913 (SC).

c) CIT vs. Hero Cycles (Private) Limited, [1997] 94 Taxman 271/228 ITR 463(SC).

d) State of Kerala and others vs. Kurian Abraham Private Limited and another, [2008] 303 ITR 284 (SC).

Hence, the attempt to disallow the privilege fee in respect of the assessment years prior to 2014-15, is clearly without reference to any legal provision. The opinion expressed by the Assessing Officer is that the amendment to Section 40(a)(iib) is clarificatory in nature. Therefore, privilege fee could be levied

only from the year 2014-15 and could not be in respect of the previous years.

This is also evident from the circumstance that the Finance Act, 2013 the Legislature has amended several other provisions of the Income Tax Act and wherever the Legislature intended that it should be retrospective, it is so specified as in the case of Section 10(23FB), 10(49), 90(5). But insofar as Section 40(a)(iib) is concerned, there is no such indication and therefore, it can only be treated as prospective from a plain reading thereof and it cannot be construed as being clarificatory. In this regard, attention is drawn to the decision in *Vatica Township* supra.

It is further contended that privilege fee is not any rate or tax levied. Disallowance was only when the payment was either rate or tax and when it is fee, cess, royalty, these further items have been brought in only by the Finance Act, 2013 with effect from the assessment year 2014-15. Section 10(4) of the 1922 Act was similarly worded as Section 40(a)(ii) with one

major difference. In that, the word 'cess' was deleted. Thus, in order to bring it into the ambit of disallowance, it would have to be specifically included in the section. It is also pointed out that the words 'royalty' or 'privilege fee' was absent in Section 40(a)(ii) of the Act. It is not levied as any rate or tax on the profits and gains of business or profession or assessed as proportion or otherwise on the basis of any such profits or gains. It is also pointed out that several types of taxes have been allowed as business expenditure in computing the income. For instance, sales tax, entry tax, import duty, export duty, purchase tax, liability excise duty, etc. Royalty paid has always been allowed as allowable business expenditure.

It is also pointed out that the revenue who has replaced several distributors who have been paying such fee would also have to take into account that the revenue has never disallowed privilege fee collected from such wholesale distributors by invoking Section 40(a)(ii). It is also a matter of record that the Central Government Undertakings like BSNL, MTNL pay

privilege fee to Central Government and the said amounts have not been disallowed invoking provisions of Section 40(a)(ii).

One other aspect which the Assessing Officer has sought to hold against the petitioner is as to the State Government being a shareholder of the company and therefore, was receiving privilege fee far in excess of what the shareholder would be entitled to, is also an observation which is irrelevant.

It is also pointed out that even appropriation of income directly or indirectly is covered by the inserted provision of Section 40(a)(iib) of the Act. The petitioner would not be provided with Distributor Licence without payment of privilege fee to the Government. The State Government being a shareholder of the petitioner, is immaterial. The capacity of receiving privilege fee is as a sovereign state and not as a shareholder of the assessee company. The role of a sovereign and that of a shareholder are different and hence, the question of treating both on the same pedestal, is incorrect.

It is also pointed out that the shareholding of the State Government is in a sum of Rs.2 crore and the privilege fee payable on the average is in excess of 28500%, which cannot be relatable to the State Government receiving such privilege fee on account of being a shareholder of the assessee. The State Government alone has the power to decide the quantum of the privilege fee. The notification issued by the State Government in exercise of powers conferred under Section 24 of the Karnataka Excise Act, 1965 read with Rule 8(4) of the Karnataka Excise (Sale of Indian & Foreign Liquors) Rules, 1968 is legitimate and in order.

The State Government has fixed certain percentage on the purchase value of the Indian made liquor (IML) and the extent of levy is by the State Government and it is not in the domain of the Assessing Officer to decide the issue.

It is contended that the commercial expediency of the assessee and the revenue cannot justifiably claim to put itself in the armchair of the businessman and assume the role to decide

how much is reasonable expenditure, having regard to the circumstances of the case. It is urged that no trader can be compelled to maximize his profits as is the settled position of law. In this regard, reliance is placed on the decision in *Hero Cycles (P) Ltd. vs. CIT 128 DTR 1 (SC)*.

It is pointed out that if a certain amount is fixed at the beginning of the year, it would be impossible for the petitioner to make payments, as the extent of business is uncertain. The business model is also such that one can sell at only certain prices. How a price is fixed is left to the contracting parties and the Income Tax Department sitting in judgment as to the mode and the manner in fixing such amount, is impermissible. The levy of privilege fee cannot be construed as appropriation of income, as a shareholder of the assessee company, the State Government is receiving dividends for its investment. The privilege fee is being received by the State on account of grant of Distribution licence.

One other aspect, namely that the amount of privilege fee fluctuating from year to year as being relatable to profits, is also misleading. The basis for such fluctuation is that the Government determines the levy of fees as a percentage on the value of transactions of the petitioner company. The intention behind fixing the fee at the end of the year is to ensure that the petitioner is not saddled with losses and undue hardship, in view of the privilege fee being far in excess of the turnover. As for example, it is pointed out that if the privilege fee is fixed at Rs.75 crore per month, it would be Rs.900 crore for the entire year, in which event, the revenue would have allowed the entire expenditure and if the resultant amount is loss, it would have allowed it to carry forward the same.

The Assessing Officer was also not justified in forming an opinion that appropriation has been made from the income quoted under the other income in the profit and loss account. The said income is also business income. In regard to the proposition that the business income can be broken up under

different heads only for the purpose of computation of total income under Income Tax, is settled in the case of ***CIT vs. Chugandas and Co. 196 LV ITR 17 (SC)***.

The dividends paid by the petitioner for the relevant assessment years, is as follows:

Assessment Year	Amount of Dividend
2010-2011	Rs.2.00 Crore
2011-2012	Rs.2.40 Crore
2012-2013	Rs.2.40 Crore
2009-2010	Rs.2.00 Crore

It is then pointed out that if the payment of privilege fee, if it is treated as dividends, would lead to an absurdity. The percentage of dividend if relatable to the privilege fee, would be unheard of in the corporate history of any company for any year, which comparison is as follows:

Assessment Year	Privilege fee	% of dividend
2010-11	570.14 crore	28507%
2011-12	695.14 crore	5792.89%
2012-13	829.41 crore	6911.79%
2009-10	479.36 crore	23968.3%

The learned counsel would contend that accounting principles provide that the company provides for all business expenditures before arriving at profit. The privilege fee is precisely the business expenditure and this cannot be excluded before arriving at profit for tax computation. The privilege fee is expenditure laid out or expended wholly and exclusively for the purpose of business and it is allowable as expenditure under Section 37(1) of the IT Act. It is levied on landed cost or purchase cost and not on profit. Therefore, it is contended that the levy of privilege fee is reasonable and allowable as business expenditure under Section 37(1) of the Act. Reliance is placed on the following judgments in support of the same:

a) Sassoon J. David and Company, Private Limited vs. CIT, (1979) 118 ITR 261 (SC).

b) Hero Cycles (Private) Limited vs. CIT, 128 ITR 1 (SC).

c) Bombay Steam Navigation Company, (1953) Private Limited vs. CIT Bombay, (1965) 56 ITR 52 (SC).

Insofar as the opinion expressed by the Assessing Officer that the amendments made to the Karnataka Excise Act as being illegal, unreasonable, irrational and unscientific, is pointed out as being outside the scope of his jurisdiction and he would have no such authority to pronounce on the said legislation. If the Department was of the view that such legislation was irrational, unscientific and unreasonable, it is open for the Department to question it before the appropriate forum and the power of the State Government to bring about such amendment also cannot be questioned. In that, the amendments made to the Excise Act are in relation to Section 24 of the Excise Act, Rule 3 Clause

(11), Rule 8 sub-rule (4), Rule 8 sub-rule (5) and Rule 8 sub-rule (13) of the Karnataka Excise (Sale of Indian & Foreign Liquors) Rules, 1968.

It is pointed out that the petitioner is issued distributorship licence under Rule 3(11) of the 1968 Rules. The State Government has levied privilege fee on the petitioner as per the provisions of Section 24 of the Excise Act and 1968 Rules. “Intoxicating liquors”, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors is enumerated at No.8 of List-II in the VII Schedule to the Constitution of India and the Legislature of the State has exclusive powers to make laws for the State in respect of any of the matters enumerated in List-II in the Seventh Schedule as per the provisions of Article 246(3) of the Constitution of India.

The fee or charges received by the Government for parting with its exclusive right to distribute as per the

provisions of Section 24 of the Excise Act and 1968 Rules, is allowable expenditure as per the provisions of the IT Act.

The Assessing Officer, seeking to question the State's power to levy fees in a federal set up, is wholly without jurisdiction.

The State exercises its power and issues a notification pursuant to the Karnataka Excise Act, which has to be complied with. For the financial year 2009-10, the Government of Karnataka had fixed privilege fee at 6.90% on the cost of purchase of IML products vide notification dated 19.03.2010.

For the subsequent years, privilege fee fixed is as follows:

Assessment Year	Government Notification Details
2010-2011	No.AE 2 PES 2007 dated 18.03.2010 6.90% on the purchase price of liquor.
2011-2012	No.FD 26 EAA 2011 dated 24.03.2011 6.90% of purchase cost of liquor.
2012-2013	No.FD 26 EAA 2011 (1) dated 24.03.2012 6.90% on the purchase cost of Liquor for the

	period April, 2011 to June, 2011. No.FD 26 EAA 2011 (2) dated 24.03.2012 7.00% on the purchase cost of Liquor for the period July, 2011 to March, 2012.
2009-2010	No.FD 02 PES 2007 dated 25.03.2009 6.85% on the purchase cost.

It is contended by Shri Shankar that in the amendment in the Karnataka Excise Act, it is clarified that the notification can be issued at any time during the year. Consequently, privilege fee paid by the petitioner is in accordance with law as per the provisions of the Excise Act. The said amendment is applicable from 30.06.2003 and is certainly clarificatory in nature and the statute has expressly intended it to be so. This is permissible in law. The opinion expressed that there is repugnancy between the State legislation and Central legislation and that the Central legislation would prevail in terms of Article 254 of the Constitution of India, is not tenable. It is not open for the Assessing Officer to raise constitutional issues in an assessment

order and create a tax liability. It is on account of this extra-legal authority exercised by the Assessing Officer that an alternative remedy of appeal insofar as the assessment orders was not found feasible and appropriate. Hence, the present petitions.

It is in this vein that the learned counsel Shri Shankar would contend that the disallowance in respect of the years prior to 2014-15 by the Assessing Officer is contended to be bad in law and that it is liable to be set aside.

4. The Respondents 1 and 2 have filed statement of objections, in support of which Shri Neeralgi would contend that any activity conducted in the line of business with an intention to earn profit even if it is a State Government undertaking, the taxable income is determined by taking cognizance of the relatable statutory provisions of the Act. He contends that there is sufficient identification of the various types of income arising out of sources like business or

profession. A plain reading of Section 37 of the IT Act would indicate that an expenditure to be allowed under this section should fit into the central theme of the section and the question was, of allowing or disallowing the deduction claimed as privilege fee in the present case on hand and this has extensively been dealt with by the Assessing Officer in the course of the assessment order with reference to true nature of the valid parameters and incidents for a fee, as distinct from other imposition such as tax, etc., and on such basis and footing, the Assessing Authority has dealt with the issue. Therefore, the learned counsel would seek to justify the order of the Assessing Authority.

It is misleading to allege that the Assessing Officer has dealt with the constitutional validity or otherwise of the said Act as sought to be contended. But, he has only proceeded to address the constitutional validity of the imposition of privilege fee and the determination of the taxable income of the petitioner

– Company in relation to the provisions of the Act. The State Government has the exclusive right to pass legislation with regard to production manufacture, sale, etc., of intoxicating liquors and also the right to levy excise duty on the same. The disallowance of privilege fee does not affect in any manner the right of the State Government to regulate liquor trade or to levy excise duty on the same. There is no direct or indirect restrictions placed on the powers of the State in this regard. At the same time, it is contended that it is the right of the Central Government to levy Income Tax on the income earned by a person, including an undertaking owned by the State Government.

It is pointed out that prior to 2003, rectified spirit, neutral spirit and IMFL were distributed through the network of about 50 licence holders in the State of Karnataka. In order to control the menace of tax evasion, the Government of Karnataka introduced the necessary legislative changes to ensure that the entire wholesale liquor distributors are canalized through the

petitioner herein which was incorporated in the year 2003. The Government of Karnataka is admittedly the 100% shareholder of the petitioner. The petitioner has taken over the distribution business hitherto conducted by about 50 license holders. Therefore, the distribution of profit arising in the hands of 50 licence holders is diverted to the State Government Undertaking, the petitioner herein.

Attention is drawn to the several assessment years commencing from the year 2004-05 including the details of the privilege fee, turnover and taxable income of the petitioner, which is indicated in a Tabular form in the body of the Statement of objections, as hereunder:

Assessment Year	Taxable Income before claiming deduction for privilege fee	Amount of privilege fee paid and the date of the government decision regarding the amount paid		Method of calculation of privilege fee	Income from sources other than liquor business for the year	Taxable Income
2004-05	21.79	21.5	02.11.2004	Lump sum	3.89	0.29
2005-06	38.57	32.00	30.03.2005	Lump sum	10.07	6.57

2006-07	47.96	41.00	20.03.2006	Lump sum	10.08	6.96
2007-08	170.67	165.54	27.03.2007	5.15.% on IML sales value	14.82	5.13
2008-09	376.97	345.38	31.03.2008	6.00% on IML sales value	29.11	31.59
2009-10	486.26	479.64	23.03.2009	6.85% on IML purchase value	38.86	6.62
2010-11	575.93	570.14	18.03.2010	6.9% on IML purchase value	36.80	5.79
2011-12	715.43	695.15	24.03.2011	6.9% on IMIL purchase value	45.49	20.28

It is contended that the above would demonstrate with clarity and by comparison, the turnover of the petitioner. During the period from 2004-05 to 2011-12, the turnover of the petitioner has increased from Rs.1297.30 crore to Rs.10,789.97 crore, but the taxable income of the petitioner has remained at very low figures. The main reason for such startling and alarming decrease is the payment of privilege fee by the petitioner to the State Government which, it is demonstrated, has increased from

Rs.21.5 crore to Rs.695.15 crore during the corresponding period. It is also pointed out that the taxable income remained lower than the other income which consists of interest, dividend, etc., which again has been taken away by the State Government. It is thereby sought to be contended that the privilege fee cannot by any stretch of imagination be considered as valid and legal, since it does not bear the characteristic features and instances of 'fee' as is known and recognized in law. Therefore, the exercise of amending the Karnataka Excise Act with retrospective effect to enable the State Government to prescribe the privilege fee at any time of the year, was obviously to ensure that the profit was conveniently characterized as 'privilege fee' and the State Government could lay its hands on the same without the same being brought to tax. Therefore, the interpretation of the provisions of the State Act relating to privilege fee and the claim of the petitioner that such fee is a first charge on profit preceding the charge of income-tax, is certainly required to be discouraged, being repugnant and

inoperative. In other words, in interpreting the provisions of the said Act, the provisions of imposition of privilege fee should be construed harmoniously with the obligation of the petitioner to discharge its liability under the Income Tax Act. It could not be the intention of the State Legislature to impose such a fee which would render the provisions of the Act otiose and non-implementable, thereby depriving the Central Government of its constitutional mandate to impose and collect tax on income other than agricultural income.

Reliance is placed on a constitutional Bench judgment in the case of *The Calcutta Gas Company (Proprietary) Ltd. vs. State of West Bengal and others AIR 1962 SC 1044* in this regard.

5. On a consideration of the above contentions and the facts and circumstances, it is not in dispute that the privilege fee which was paid by the petitioner to the State Government for the years 2004-05, 2005-06, 2006-07 was allowed as business expenditure. The respondents 1 and 2 have drawn inspiration

from the 2013 amendment, whereby Clause (iib) of sub-clause (a) of Section 40 of the IT Act was inserted by the Finance Act, 2013 with effect from 1.4.2014. This apparently has been held by the Assessing Authority as being clarificatory in nature and has sought to apply it with retrospective effect. In that, the Assessing Officer has passed the assessment order disallowing the privilege fee paid as business expenditure on the very date of the Budget. Though the Assessing Officer has taken a view that the privilege fee would be disallowed as business expenditure even prior to the amendment by insertion of sub-clause (iib) of clause (a) of Section 40 of the IT Act, the Assessing Officer feels fortified in his view on such amendment and it is also his opinion that it is merely clarificatory in nature and that such expenditure cannot be allowed as business expenditure and is liable to tax and the liability is with retrospective effect and hence is justified in seeking to disallow such expenditure over the years. On a further reasoning, it is sought to be demonstrated with reference to comparison of the

privilege fee, the turnover, taxable income of the petitioner for the years 2004-05 upto 2011-12 as if to demonstrate the shocking increase in the turnover of the petitioner while the taxable income has remained low and therefore, the petitioner seeking to use this as a device to evade tax.

Therefore, the primary reasoning of the Assessing Officer is that the privilege fee imposed is unreasonable and does not take on the characteristic of a privilege fee and it could not be construed as a fee at all and it is merely a device to evade tax.

In this regard, as pointed out by the learned Advocate General Shri Madhusudan Naik, a Constitution Bench of the Supreme Court in the case of *Har Shankar v. Deputy Excise and Taxation Commissioner AIR 1975 SC 1121*, has expounded on the distinction between a 'tax' and 'fee' and the characteristics of these two as also excise duty, in the following words:

55. Since rights in regard to intoxicants belong to the State, it is open to the Government to part with those rights for a consideration. By Article 298 of the Constitution, the executive power of the State extends to the carrying on of any trade or business and to the, making of contracts for any purpose. As observed in *Harinarayan Jaiswal's case*, "if the Government" is the exclusive owner of those privileges, reliance on Article 19 (1) (g) or Article 14 becomes irrelevant. Citizens cannot have any fundamental right to trade or carry on business in the properties or rights belonging to the Government, nor can there be any infringement of Article 14, if the Government tries to get the best available price for its valuable rights." Section 27 of the Act recognises the right of the Government to grant a lease of its right to 'manufacture, supply or sell intoxicants. Section 34 of the Act read with Section 59(d) empowers the Financial Commissioner to direct that a licence, permit or pass be granted under the Act on payment of such fees and subject to such restrictions and on such conditions as he may prescribe. In such a scheme, it is not of the essence whether the amount charged to the licensees is predetermined as in the appeals of *Northern India Caterers* and of *Green Hotel* or whether it is left to be determined

by bids offered in auctions held for granting those rights to licensees. The power of the Government to charge a price for parting with its rights and not the mode of fixing that price is what constitutes the essence of the matter. Nor indeed does the label affixed to the price determine either the true nature of the charge levied by the Government or its right to levy the same.

56. The distinction which the Constitution makes for legislative purposes between a 'tax' and a 'fee' and the characteristic of these two as also of 'excise duty' are well-known. "A tax is a compulsory exaction of money by public authority for public purposes enforceable by law and is not a payment for services rendered". Per Latham, C.J. in Mathews vs. Chickor Marketing Board, 60 CLR 263, 276. A fee is a charge for special services rendered to individuals by some governmental agency and such a charge has an element in it of a quid pro quo. Commissioner H.R.E. Madras vs. Lakshmindra Thirtha Swamiar, 1954 SCR 1005, 1041 = (AIR 1954 SC 282 at p. 295). Excise duty is primarily a duty on the production or manufacture of goods produced or manufactured within the country M/s. Guruswamy & Co. vs. State of Mysore, (1967) 1 SCR 548 = (AIR 1967 SC 1512). The amounts, charged to the

licensees in the instant case are, evidently, neither in the nature of tax nor excise duty. But then, the 'Licence fee' which the State Government charged to the licensees through the medium of auctions or the 'Fixed fee' which it charged to the vendors of foreign liquor holding licences in Forms L-3, L-4 and L- 5 need bear no, quid pro quo to the services rendered to the licencees. The word 'fee' is not used in the Act or the Rules in the technical sense of the expression. By 'licence fee' or 'fixed fee' is meant the price or consideration which the Government charges to the licensees for parting with its privileges and granting them to the licensees. As the State can carry on a trade or business, such a charge is the normal incident of a trading, or business transaction.

59. The argument that in Cooverjee's case 1954 SCR 873 = (AIR 1954 SC 220) the impugned power having been exercised in respect of a centrally administrated area, the power was not fettered by legislative lists loses its relevance in the view we are taking. It is true that in that case it was permissible to the court to find, as in fact it did, that the fee imposed on the licences was, "more in the nature of a tax than a licence fee". As the authority which levied the fee had the

power to exact a tax, the levy could be upheld as a tax, even if it could not be justified as a 'fee', in the constitutional sense of that term. But the 'Licence fee' or 'Fixed fee' in the instant case does not have to conform to the requirement that it must bear a reasonable relationship with the services rendered to the licensees. The amount charged to the licensees is not a fee properly so-called nor indeed a tax but is in the nature of the price of a privilege, which the purchaser has to pay in any trading or business transaction."

In any event, with the insertion of sub-clause (iib) in the Act, it would no longer be possible for the petitioner to claim that the said privilege fee is not taxable. The question as to whether the said provision can be applied with retrospective effect, is the only question that would remain for consideration. As rightly pointed out by Shri Shankar, a plain reading of the provision would not indicate that it is to be applied with retrospective effect. There are other provisions which were also amended, and wherever the Legislature intended that certain provisions would have retrospective effect, it is expressly

indicated therein and therefore, there being no such express indication insofar as the present provision with which we are concerned, it cannot be said to be applicable with retrospective effect. This is also evident from the CBDT circular No.3/2014 dated 24.01.2014 issued by the Department, which would be binding on the Assessing Authority, the relevant portion of which reads as follows:

“12. Disallowance of certain fee, charge, etc.
in the case of State Government Undertakings:

12.1 The provisions of Section 40 of the Income-tax Act, 1961 before its amendment by the Act, specifies the amounts which shall not be deducted in computing the income chargeable under the head “Profits and gains of business or profession”. The non-deductible expense under the said section also includes statutory dues like fringe benefit tax, income-tax, wealth-tax, etc. Disputes have arisen in respect of income-tax assessment of some State Government undertakings as to whether any sum paid by way of privilege fee, license fee, royalty, etc. levied or charged by the State Government exclusively on its undertakings are deductible or not for the purposes of

computation of income of such undertakings. In some cases, orders have been issued to the effect that surplus arising to such undertakings shall vest with the State Government. As a result it has been claimed that such income by way of surplus is not subject to tax. It is a settled law that State Government undertakings are separate legal entities than the State and are liable to income-tax.

12.2. In order to protect the tax base of State Government undertakings *vis-a-vis* exclusive levy of fee, charge, etc. or appropriation of amount by the State Governments from its undertakings, section 40 of the Income-tax Act has been amended to provide that any amount paid by way of fee, charge, etc., which is levied exclusively on, or any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government, shall not be allowed as deduction for the purposes of computation of income of such undertakings under the head “Profits and gains of business or profession”. The expression “State Government Undertaking” for this purpose includes –

(i) a corporation established by or under any Act of the State Government;

(ii) a company in which more than fifty per cent, of the paid-up equity share capital is held by the State Government;

(iii) a company in which more than fifty per cent, of the paid-up equity share capital is held by the entity referred to in clause (i) or clause (ii) (whether singly or taken together);

(iv) a company or corporation in which the State Government has the right to appoint the majority of the directors or to control the management or policy decisions, directly or indirectly, including by virtue of its shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

(v) an authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government.

12.3 Applicability.- This amendment takes effect from 1st April, 2014 and will, accordingly, apply in relation to the assessment year 2014-15 and subsequent assessment years.”

Further, Clause 7 which is appended to the Finance Bill, 2013, reads as follows:

“Clause 7 of the Bill seeks to amend Section 40 of the Income-tax Act relating to amounts not deductible.

The provisions of Section 40 specify the amounts which shall not be deducted in computing the income chargeable under the head “Profits and gains of business or profession”.

It is proposed to insert a new sub-clause (iib) in clause (a) of the aforesaid section so as to provide that any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called which is levied exclusively on or any amount which is appropriated, whether directly or indirectly, from a State Government undertaking by the State Government, shall not be allowed as deduction in computing the income chargeable under the head “Profits and gains of business or profession”.

It is further proposed to define the expression “State Government undertaking” used in the proposed new sub-clause (iib).

This amendment will take effect from 1st April, 2014 and will, accordingly, apply in relation to the

assessment year 2014-15 and subsequent assessment years.”

Therefore, it can safely be said that the privilege fee payable by the petitioner to the State Government would be taxable with effect from 1.4.2014 and not prior thereto. The unreasonableness of the privilege fee payable is also not a ground to hold that it is a device by which the petitioner and the State Government are avoiding payment of tax. In this regard, reliance is placed on *Har Shankar* supra, which is clear on this aspect and therefore, it was not open for the Assessing Officer to opine that privilege fee appears to be relatable to the profit earned and a large chunk of it is transferred to the State Government in the name of privilege fee. It is settled law that there is no illegality committed by the petitioner in paying such privilege fee on the State Government having fixed such privilege fee. There is no legal prohibition in this regard and therefore, it cannot be said that the same could have been disallowed by the Assessing Officer.

It requires to be emphasized that the Supreme Court in *Har Shankar supra* has expressed that, 'the power of the Government to charge a price for parting with its rights and not the mode of fixing the price is what constitutes the essence in the exercise of the matter', are the words used by the Supreme Court in dealing with the privilege of the State Government to fix such a privilege fee. Therefore, it would aptly apply in the facts and circumstances of these cases insofar as the Assessing Officer having expressed an opinion of the State Government having exercised its power "unscientifically, illegally and irrationally". (sic)

Consequently, these petitions are allowed. The impugned assessments are set aside insofar as it treats the privilege fee paid as being taxable to income.

Insofar as the other disallowances are concerned, the matter is remanded to the Assessing Officer to re-examine the

same after affording an opportunity of hearing to the petitioner
in respect of the several assessment years.

**Sd/-
JUDGE**

KS