M/S. PUNJAB AROMATICS

v.

STATE OF KERALA

(Civil Appeal No. 3160 of 2008)

APRIL 30, 2008

[S.H. KAPADIA AND B. SUDERSHAN REDDY, JJ.]

Kerala General Sales Tax Act, 1963 – s.5A – Appellant-assessee purchased red oil from unregistered dealers and converted same into sandalwood oil by removing water content and other impurities – Whether the process of such conversion amounted to consumption/use of red oil in manufacture of sandalwood oil and attracted levy under s.5A – Held, No, as "test of irreversibility" not satisfied – The final product i.e. sandalwood oil could be brought back to the original state, namely, red oil by adding impurities – Red oil was not subsumed into sandalwood oil.

Interpretation of Statutes – Fiscal legislation – Held: In tax matters, Courts have to keep in mind distinction between approach and principle – Courts have to go by the principle involved in the fiscal legislation.

Appellant-assessee purchased red oil from unregistered dealers and converted the same into sandalwood oil by removing water content and other impurities.

According to the Department, the said process of conversion amounted to consumption/use of red oil in the manufacture of sandalwood oil and attracted levy under s.5A of the Kerala General Sales Tax Act, 1963.

Per contra, contention of the assessee is that the process of purification is not manufacture and removal of impurities by process of filtration did not amount to consumption/use in the manufacture of sandalwood oil

A in terms s.5A of the Act. It was further contended on behalf of the assessee that the basic structure and composition of "red oil" remained same even after the purification process and, therefore, the Department erred in treating red oil and sandalwood oil as two separate and distinct B commodities.

Allowing the appeal filed by the assessee, the Court

HELD: 1.1. When raw-material is converted into a final product, one of the important tests to be applied to C ascertain whether the process of conversion amounts to manufacture is: whether the raw-material is subsumed into the final product. In the present case, the highest fact-finding body is Appellate Tribunal under the Kerala General Sales Tax Act, 1963. After examining the process, D it came to the conclusion that sandalwood oil (final product) can be brought back to the original state, namely, red oil by adding impurities, therefore, the process is reversible. Therefore, red oil is not subsumed into sandalwood oil. Keeping in mind this basic test, it is clear that red oil is not consumed/used in the manufacture of E sandalwood oil. Hence, s.5A(1)(a) or (b) of the Act has no application. [Para 8] [239-G-H; 240-A-B]

1.2. The "test of irreversibility" is an important criterion to ascertain as to when a given process amounts F to manufacture. In the present case that test is not satisfied. In the circumstances, it cannot be said that red oil and sandalwood oil are two separate and distinct products as held by the High Court overruling the judgment of the Tribunal. [Para 12] [241-E-F]

G 1.3. In tax matters, Courts have to keep in mind distinction between approach and principle. The Courts have to go by the principle involved in the fiscal legislation. In the present case, the decision of the Tribunal was objective. It was based on the correct formulation of the H test of irreversibility involved in the process of

manufacture and, therefore, the High Court was not justified in observing that the finding of the Tribunal was patently absurd and perverse. [Para 17] [242-G-H; 243-A] A

Burmah-Shell Oil Storage and Distributing Co. of India Ltd., Beglaum v. Belgaum Borough Municipality, Belgaum **AIR (1963) SC 906 and** *State of Karnataka v. B. Raghurama Shetty and Others* **(1981) 2 SCC 564 – held inapplicable.** B

M/s. Tungabhadra Industries Ltd. v. The Commercial Tax Officer, Kurnool **– (1961) 2 SCR 14;** *Shyam Oil Cake Ltd. v. Collector of Central Excise, Jaipur* **(2005) 1 SCC 264 and** *The State of Tamil Nadu v. Subbaraj and Co.* **(1981) 47 STC 30 – referred to.** C

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 3160 of 2008.

From the Judgment and Order dated 21.12.2006 of the High Court of Kerala at Ernakulam in TRC Nos. 78, 79 of 2003, St. Rev. Nos. 36 of 2003, 409, 411, 315 and 430 of 2004. D

Soli J. Sorabjee, Garvesh Kabra, Pratesh Kapoor and Vishwa Pal Singh for the Appellant. E

T.L.V. Iyer, R. Sathish for the Respondent.

The Judgment of the Court was delivered by

KAPADIA, J. 1. Leave granted. F

2. This civil appeal filed by the assessee raises the question relating to liability to pay "purchase tax" under Section 5A of the Kerala General Sales Tax Act, 1963 ("1963 Act", for short).

3. Appellant-assessee purchases "red oil" from G unregistered dealers and converts such red oil into "sandalwood oil" by removing water content and other impurities. As regards the processing, there is no dispute between the parties. The case of the Department, in short, is that the assessee is not selling red oil as such; that the commodity purchased (i.e. red H

A oil) by the assessee has undergone manufacture when it is heated to a specified degree and the same is filtered by which impurities are removed and, therefore, according to the Department, conversion of red oil into sandalwood oil attracts levy under Section 5A of the 1963 Act.

B 4. For the sake of convenience we quote Section 5A of the 1963 Act which reads as follows:

> **"5A. Levy of purchase tax.** – (1) Every dealer who, in the course of his business, purchases from a registered
> C dealer or from any other person any goods, the sale or purchase of which is liable to tax under this Act, in circumstances in which no tax is payable under sub-sections (1), (2), (3), (4) or (5) of Section 5 and either.
>
> (a) consumes such goods in the manufacture of other
> D goods for sale or otherwise; or
>
> (b) uses or disposes of such goods in any manner other than by way of sale in the State;"

5. A short question which arises for determination in this
E civil appeal is : whether the above process amounts to consumption/use of red oil in the manufacture of sandalwood as contended on behalf of respondent-Department.

6. Shri Soli J. Sorabjee, learned senior counsel appearing on behalf of the appellant, submits that the removal of impurities
F by process of filtration does not amount to consumption/use in the manufacture of sandalwood oil in terms of Section 5A of the 1963 Act. Learned counsel submits that the assessee has paid tax on the final product, namely, sandalwood oil sold locally (SEE: averments made by the assessee in that connection in the
G synopsis of the civil appeal paper book). Learned counsel submits that process of purification is not manufacture. In this connection it is submitted that the basic structure and composition of the red oil remains same even after the purification process and, therefore, the Department has erred
H in treating red oil and sandalwood oil as two separate and

distinct commodities. On the question whether such purification process amounts to manufacture or not, learned counsel places reliance on several judgments of this Court in support of his contention.

7. Per contra, Shri T.L.V. Iyer, learned senior counsel appearing on behalf of the Department, submits that red oil and sandalwood oil are two separate and distinct commodities. Learned counsel submits that red oil containing impurities has no value in the market. According to learned counsel, it is only the sandalwood oil which has market value. Learned counsel further submits that Section 5A of the 1963 Act has been enacted by the Legislature as it wanted to bring, within the scope of purchase tax, items purchased from unregistered dealers without payment of tax for consumption/use. In this connection, learned counsel places reliance on the Amending Act 3 of 1990 by which Section 5A stood amended to bring within the scope of purchase tax items purchased from unregistered dealer without payment of tax for "use". According to learned counsel, in the present case red oil is a raw-material, that it has been purchased by the assessee and it has been consumed/used in the manufacture of sandalwood oil (final product) and, therefore, assessee is liable to pay purchase tax on purchase turnover of red oil under Section 5A(1)(a) or (b) of the 1963 Act.

8. We find merit in this civil appeal filed by the assessee. At the outset, it may be stated that process of purification is not in dispute. The entire process of purification has been discussed by the Tribunal in its judgment. The said process eliminates impurities. In the present case we are required to consider the words "consumes such goods (red oil) in the manufacture of other goods for sale or otherwise (sandalwood oil)". These words find place in Section 5A(1)(a) of the 1963 Act. When raw-material is converted into a final product one of the important tests to be applied to ascertain whether the process of conversion amounts to manufacture is : whether the raw-material is subsumed into the final product. In this case, the highest fact-finding body is Appellate Tribunal under the 1963 Act. After

A examining the process, it has come to the conclusion that sandalwood oil (final product) can be brought back to the original State, namely, red oil by adding impurities, therefore, the process is reversible. Therefore, red oil is not subsumed into sandalwood oil. Keeping in mind this basic test, it is clear that
B red oil is not consumed/used in the manufacture of sandalwood oil. Hence, Section 5A(1)(a) or (b) of the 1963 Act has no application.

9. In the case of *M/s. Tungabhadra Industries Ltd. v. The Commercial Tax Officer, Kurnool* – 1961 (2) SCR 14, the
C question which arose for determination was : whether hydrogenated groundnut oil continues to be groundnut oil notwithstanding the hydrogenation process. It was held that hydrogenation process eliminated impurities and, therefore, in its essential nature there was no change amounting to
D manufacture. We quote hereinbelow relevant portion of the said judgment which reads as follows:

> "When raw groundnut oil is converted into refined oil, there is no doubt processing, but this consists merely in removing from raw groundnut oil that constituent part of
E the raw oil which is not really oil. The elements removed in the refining process consist of free fatty acids, phosphotides and unsaponifiable matter. After the removal of this non-oleic matter therefore, the oil continues to be groundnut oil and nothing more. The matter removed from
F the raw groundnut oil not being oil cannot be used, after separation, as oil or for any purpose for which oil could be used. In other words, the processing consists in the non-oily content of the raw oil being separated and removed, rendering the oily content of the oil 100 per cent. For this
G reason refined oil continues to be groundnut oil within the meaning of Rules 5(1)(*k*) and 18(2) notwithstanding that such oil does not possess the characteristic colour, or taste, odour etc. of the raw groundnut oil."

10. The judgment of this Court in the case of *Tungabhadra*

industries Ltd. (supra) has been considered once again by this Court in the case of *Shyam Oil Cake Ltd. v. Collector of Central Excise,* Jaipur – (2005) 1 SCC 264. We quote hereinbelow para 18 of the said judgment in the case of *Shyam Oil Cake Ltd.* (supra) which reads as follows:

> **"18.** Thus, this Court has held that prior to refining, it was raw groundnut oil and after refining even though the characteristic colour, taste and odour may have changed it remained groundnut oil. In other words, this Court held that there was no manufacture of a new and distinct commodity."

11. Section 5A(1)(a) of the 1963 Act is similar to Section 7A(1)(a) of the Tamil Nadu General Sales Tax Act, 1959. That Section 7A(1)(a) of the Tamil Nadu General Sales Tax Act, 1959 came for interpretation before the Madras High Court in the case of *The State of Tamil Nadu v. Subbaraj and Co.* – (1981) 47 STC 30 in which it was held that the very use of the word "consume" contemplates that the goods purchased should have been devoured or exhausted in the process of manufacture with the result, *its identity must have been completely lost.*

12. The "test of irreversibility" is an important criterion to ascertain as to when a given process amounts to manufacture. In the present case that test is not satisfied. In the present case, the Tribunal has examined the process and has come to the conclusion that by adding impurities to the sandalwood oil the product could become red oil once again. In the circumstances, it cannot be said that red oil and sandalwood oil are two separate and distinct products as held by the High Court overruling the judgment of the Tribunal.

13. One more aspect needs to be mentioned. According to the impugned judgment of the High Court, even assuming for the sake of argument that Section 5A(1)(a) of the 1963 Act is not applicable still in any event alternatively Section 5A(1)(b) stood attracted.

A 14. The said reasoning in the impugned judgment is erroneous. Section 5A(1)(b) is quoted hereinabove. In that section the words used are "uses or disposes of such goods in any manner other than by way of sale in the State". The said words "uses or disposes of" signifies the test of irreversibility. B However, as stated above, the Tribunal is the highest fact-finding authority under the Act which has examined the process and has held that the test of irreversibility is not applicable as sandalwood oil can be brought back to the original state of red oil by adding impurities. (SEE: page no.66 of the civil appeal C paper book).

15. For the aforestated reasons, we are of the view that there is no infirmity in the judgment of the Tribunal and that the High Court had erred in interfering with the said judgment.

D 16. Before concluding we quote hereinbelow the last paragraph of the impugned judgment of the High Court which reads as follows:

> "We do not know on what basis the Tribunal has assumed that in order to attract liability under Section 5A manufacture E of a product should be done with the use of chemicals. *We are constrained to observe that the finding of the Tribunal is patently absurd and perverse.* We therefore allow the Tax Revision cases, reversing the orders of the Tribunal, upholding levy of tax under Section 5A of the Act F on the purchase turnover of red oil by respondents-assessees for all the years."

17. To say the least, in tax matters courts have to keep in mind distinction between approach and principle. Courts have to go by the principle involved in the fiscal legislation. Keeping G in mind the distinction between these two concepts, we are of the view that the High Court was not justified in making the observation which is underlying hereinabove. The decision of the Tribunal is objective. It is based on the correct formulation of the test of irreversibility involved in the process of H manufacture and, therefore, the High Court was not justified

in observing that the finding of the Tribunal was patently absurd and perverse. A

18. We may, however, refer to the judgment of this Court in the case of **Burmah-Shell Oil Storage and Distributing Co. of India Ltd., Beglaum v. Belgaum Borough Municipality, Belgaum – AIR 1963 SC 906** on which heavy reliance is placed by Shri T.L.V. Iyer, learned senior counsel appearing on behalf of the respondent-Department. In that case proceedings commenced against the Municipality under Article 226 of the Constitution to prohibit the Municipality from charging octroi from Burmah-Shell on its products brought inside the octroi limits for sale. The products were petroleum products. They were brought inside the Municipality area for use or consumption by itself or for sale to its dealers. The said company had paid octroi on its products brought within the octroi limits of the Municipality including the goods not consumed by itself but sold to others. At this stage, it may be mentioned that by the impugned amendment the Municipality Act stood amended to include the word "sale" in the description of octroi. The company contended that the tax could not be collected on goods which were merely sold but not consumed inside the octroi limits. It was urged on behalf of the company that the words "consumption or use" must be contrasted with the word "sale". In support of this contention, the company referred to Entry 49 of List II of Government of India Act, 1935, and also to Entry 52 of the State List in the Constitution. It is in this context that this Court examined the word "consumption" vide paras 19 and 20 which are quoted hereinbelow: B C D E F

> "19. The history of these two taxes clearly shows that while terminal taxes were a kind of octroi which were concerned only with the entry of goods in a local area irrespective of whether they would be used there or not; octrois were taxes on goods brought into the area for consumption, use or sale. They were leviable in respect of goods put to some use or other in the area but only if they were meant for such user. When the Government of India Act, in its G H

A Scheduled Tax Rules, mentioned "octrois", it intended to give the power to levy taxes in this well-understood sense, namely, on the entry of goods in a local area for consumption, use or sale. The Boroughs Act, which was enacted in 1925 mentioned only "consumption and use."
B Ever since its enactment, no dispute seems to have been raised by any person that goods brought in for sale were exempt from octrois. All persons who brought the goods apparently paid this tax without objection. It was only in 1954 when the Legislature seeking to bring the description
C of octroi in the Municipal Act in line with the Constitution included the word "sale" also, that the dispute was raised by persons who were affected, and they were some of the persons who had paid the tax before, even though the word "sale" was not there. Of course, the conduct of the
D tax-payer is not determinative of the meaning of the words "consumption or use." But it shows how the term was always understood. The word consumption in its primary sense means the act of consuming and in ordinary parlance means the use of an article in a way which destroys, wastes or uses up that article. But in some legal
E contexts, the word "consumption" has a wider meaning. It is not necessary that by the act of consumption the commodity must be destroyed or used up. The word "consumption" occurs in explanation to sub-Article 1 of Article 286 of the Constitution. In explaining the ambit of
F that word this Court observed in The State of Bombay v. The United Motors (India) Ltd. ([1953] S.C.R. 1069, 1084), as follows :-

"The expression "for the purpose of consumption in that
G State" must, in our opinion, be understood as having reference not merely to the individual importer or purchaser but as contemplating distribution eventually to consumers in general within the State."

20. It is not the immediate person who brings the goods
H into a local area who must consume them himself, the act

of consumption may be postponed or may be performed by someone else but so long as the goods have been brought into the local area for consumption in that sense, no matter by whom, they satisfy the requirements of the Boroughs Act and octroi is payable. Added to the word "consumption" is the word "use" also. There may be certain commodities which though put to use are not 'used up' in the process. A motor-car brought into an area for use is not used up in the same sense as food-stuffs. The two expressions use and consumption together therefore, connote the bringing in of goods and animals not with a view to taking them out again but with a view to their retention either for use without using them up or for consumption in a manner which destroys, wastes or uses them up. In this context, the word "consumption", as has been shown above, must receive a larger meaning than merely the act of consuming in the generally understood sense. Recently, in M/s. Anwarkhan Mahboob Co. v. The State of Bombay (1961) 1 SCR 709 at p.715: AIR 1961 SC 213 at p. 216, while dealing with the Explanation to Article 286(1), this Court observed as follows :-

"In answering that question it is unnecessary and indeed inexpedient to attempt an exhaustive definition of the word "consumption" as used in the explanation to Art 286 of the Constitution. The act of consumption with which people are most familiar occurs when they eat, or drink or smoke. Thus, we speak of people consuming bread, or fish or meat or vegetables, when they eat these articles or food; we speak of people consuming tea or coffee or water or wine, when they drink these articles; we speak of people consuming cigars or cigarettes or bidis, when they smoke these. The production of wealth, as economists put it, consists in the creation of "utilities." Consumption consists in the act of taking such advantage of the commodities and services produced as constitutes the 'utilization' thereof. For each commodity, there is ordinarily what is

A generally considered to be the final act of consumption. For some commodities, there may be even more than one kind of final consumption. Thus grapes may be "finally consumed" by eating them as fruits; they may also be consumed by drinking the wine prepared from "grapes". B Again, the final act of consumption may in some cases be spread over a considerable period of time. Books, articles of furniture, paintings may be mentioned as examples. It may even happen in such cases, that after one consumer has performed part of the final act of consumption, another C portion of the final act of consumption may be performed by his heir or successor-in-interest, a transferee, or even one who has obtained possession by wrongful means. But the fact that there is for each commodity what may be considered ordinarily to be the final act of consumption, D should not make us forget that in reaching the stage at which this final act of consumption takes place the commodity may pass through different stages of production and for such different stages, there would exist one or more intermediate acts of consumption..... In the absence of any words to limit the connotation of the word E "consumption" to the final act of consumption, it will be proper to think that the constitution-makers used the word to connote any kind of user which is ordinarily spoken of as consumption of the particular commodity."

F 19. We are of the view that the judgment of this Court in **Burmah-Shell (supra)** has no application. Firstly, in that case the Court was concerned with the interpretation of Entries in the Legislative Lists. It is well-settled that Entries in the Legislative Lists have to be read in the widest possible sense. The Entries G in the Legislative Lists demarcates an area/field within which the competent Legislature is entitled to enact laws. We are not concerned with interpretation of Entries in the Legislative Lists, therefore, the said judgment has no application to the facts of the present case. Secondly, as can be seen from para 20, this Court has itself clarified that the word "consumption" in the H

Explanation to Article 286 of the Constitution as it stood before the Constitution (Sixth Amendment) Act, 1956 has to be read in a manner different from the act of consumption in the generally understood sense. For both the aforestated reasons, the judgment of this Court in **Burmah-Shell (supra)** has no application to the present case.

20. Shri T.L.V. Iyer, learned counsel, also places heavy reliance on the judgment of this Court in the case of *State of Karnataka v. B. Raghurama Shetty and Others* – (1981) 2 SCC 564. He places reliance on paragraphs 8 and 9 which are quoted hereinbelow:

> "8. There is no merit in the submission made on behalf of the assessees that they had not consumed paddy when they produced rice from it by merely carrying out the process of dehusking at their mills. Consumption in the true economic sense does not mean only use of goods in the production of consumers' goods or final utilisation of consumers' goods by consumers involving activities like eating of food, drinking of beverages, wearing of clothes or using of an automobile by its owner for domestic purposes manufacturer also consumes commodities which are ordinarily called raw materials when he produces semi-finished goods which have to undergo further processes of production before they can be transformed into consumers' goods. At every such intermediate stage of production, some utility or value is added to goods which are used as raw materials and at every such stage the raw materials are consumed. Take the case of bread. It passes through the first stage of production when wheat is grown by the farmer, the second stage of production when wheat is converted into flour by the miller and the third stage of production when flour is utilised by the baker to manufacture bread out of it. The miller and the baker have consumed wheat and flour respectively in the course of their business. We have to understand the word 'consumes' in Section 6(i) of the Act in this economic

A sense. It may be interesting to note that this is the basis of the levy of 'Value Added Tax', popularly called as VAT, which is levied as an alternative to tax on turnover in some Western countries. The difference between 'Value Added Tax', and tax on the turnover of sales or purchases is B explained by Professor Paul A. Samuelson in his book entitled 'Economics' (Tenth Edition, 1976) at page 168 thus :

A turnover tax simply taxes every transaction made : wheat, flour, dough, bread, VAT is different because it does not C include in the tax on the miller's flour that part of its value which came from the wheat he bought from the farmer. Instead, it taxes him only on the wage and salary, cost of milling, and on the interest, rent, royalty, and profit cost of this milling stage of production. (That is, the raw material D costs used from earlier stages are subtracted from the miller's selling price in calculating his "value added" and the VAT tax on value added....)

9. At every stage of production, it is obvious there is consumption of goods even though at the end of it there E may not be final consumption of goods but only production of goods with higher utility which may be used in further productive processes."

21. In our view the said judgment has no application as in F that case this Court came to the conclusion that paddy and rice are two different commodities. It was further held on facts that the assessee had consumed paddy in the manufacture of rice. It is in this context that after coming to the conclusion that paddy and rice are two different commodities that this Court has G examined the word "consumption" in the economic sense. In the present case, as stated hereinabove, by adding of impurities sandalwood oil becomes red oil. Therefore, there was no consumption of red oil in the manufacture of sandalwood oil. Further, it may be noted that the Explanation to Article 286(1)(a) of the Constitution, as it stood prior to the Constitution (Sixth H

Amendment) Act, 1956, used the word "consumption" in the Explanation to the said Article. However, after the Constitution (Sixth Amendment) Act, 1956 w.e.f. 11.9.1956 the said Explanation to Article 286(1)(a) of the Constitution is omitted. For the aforestated reasons, the judgment of this Court in the case of **B. Raghurama Shetty (supra)** has no application.

22. Accordingly, the civil appeal filed by the assessee stands allowed and the impugned judgment of the High Court dated 21.12.06 is set aside with no order as to costs.

B.B.B. Appeal allowed.