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Court No.32

Judgment reserved on 30.08.2012
Judgment delivered on 16.10.2012

Income Tax Appeal No.110 of 2001
Commissioner of Income Tax (Central), Kanpur
Vs. M/s Kothari Pouches Ltd., Kanpur
Assessment Year 1990-91

Income Tax Reference No.12 of 2001
Commissioner of Income Tax (Central), Kanpur
Vs. M/s Kothari Pouches Ltd., Kanpur
Assessment Year 1991-92

Income Tax Appeal No.526 of 2012
Commissioner of Income Tax (Central), Kanpur
Vs. M/s Kothari Pouches Ltd., Kanpur
Assessment Year 1992-93

Income Tax Appeal (Def.) No.93 of 2001
Commissioner of Income Tax (Central), Kanpur
Vs. M/s Kothari Pouches Ltd., Kanpur
Assessment Year 1993-94

Income Tax Appeal (Def.) No.83 of 2001
Commissioner of Income Tax (Central), Kanpur
Vs. M/s Kothari Pouches Ltd., Kanpur
Assessment Year 1994-95

Income Tax Appeal No.528 of 2012
Commissioner of Income Tax (Central), Kanpur
Vs. M/s Kothari Pouches Ltd., Kanpur
Assessment Year 1995-96

Hon. Sunil Ambwani, J.
Hon. Aditya Nath Mittal, J.

1. We have heard Shri R.K. Upadhyay and Shri Dhananjay Awasthi, learned counsel for the income tax department. Shri V.B. Upadhyay, Sr. Advocate assisted by Shri S.K. Garg, Shri R.S. Agrawal and Shri Ashish Bansal appear for the respondents.

2. In all these income tax appeals filed on behalf of the revenue for the assessment years 1990-91; 1991-92; 1992-93;

1993-94 and 1995-96, the substantial question of law raised on which the appeals have been admitted is as follows:-

> *"(1) Whether on the facts and in the circumstances of the case the Hon'ble ITAT was justified in holding that Zarda Yukta Pan Masala is not a tobacco preparation under Item 2 of Schedule XI of the I.T. Act."*

3. The assessee is engaged in manufacturing Pan Masala and other pan flavouring products including Zarda Yukta Pan Masala. The Zarda Yukta Pan Masala has a significant portion of Zarda pungent flavour of tobacco, which according to the department is consumed by persons, who are addicted to tobacco. A normal person does not consume Zarda Yukta Pan Masasla unless he buys it for the purposes of using it as tobacco preparation, which is also injurious to health and which is specifically printed on the pouches.

4. The assessee claimed deduction under Section 80I of the Income Tax Act, which falls in Chapter VI A "Deductions in respect of profits and gains from industrial undertaking after a certain date etc." The assessee was required to explain as to what was the use of tobacco in pan masala, in as much as tobacco preparation as item no.2 in Schedule XI of the Act with reference under Section 80I (2) (iii). In case of an assessee manufacturing or producing any article not being any article or thing specified in the list of Schedule XI etc. is entitled to for deduction under Section 80I of the Act. The assessee was required to explain as to why the deductions under Section 32AB and 80I may not be disallowed on the profits attributable to Zarda Yukta Pan Masala because it was tobacco preparation. Item No.2 of the Schedule XI of the Act includes 'tobacco and tobacco preparation, such as cigars and cheroots, cigarettes, biries, chewing tobacco and snuff'. The A.O. vide order under Section 143 (3) held that Zarda Yukta Pan Masala cannot be treated as non-tobacco preparation

because common man, addicted of tobacco prefers to the use of Zarda Yukta Pan Masala. The A.O. disallowed the claim of the assessee for deduction under Section 80I, as according to him the product is covered under Item 2 of Schedule XI of the IT Act, which debars the assessee to avail the benefits granted by the Statute.

5. The assessee filed an appeal before the CIT (A), Kanpur, which by its order dated 25.2.2000 allowed the appeal and directed the A.O. to allow the claim under Section 80I at Zarda Yukta Pan Masala. The CIT (A) dismissed the appeal for the assessment year 1990-91 vide order dated 17.3.1993 on identical issues. The department filed an appeal against the order before the ITAT, Allahabad, which by its order dated 30.3.2001 dismissed the appeal with following observations:-

> *"We have considered the rival submission. In view of the fact that the Tribunal following its order in case of M/s Kothari Products Ltd., Kanpur, a sister concern having the same proportion of zarda yukta pan masala there cannot be a different conclusion in respect of the appellant-assessee also. Therefore we direct the AO not to treat the zarda yukta pan masala as a tobacco preparation within the meaning of entry 2 of Schedule XI of the I.T. Act and also direct that the claim of deduction u/s 80-I be allowed to the appellant assessee."*

6. In the judgment dated 30.3.2001 the Tribunal relied upon its own order in Kothari Products Ltd. in the assessment year 1987-88 to 1991-92, where it had held that Zarda Yukta Pan Masala is not a tobacco preparation. Against this order of the Tribunal the department had filed reference application in the High Court. The High Court by its order dated 18.7.1995 held that no question of law arise out of the order passed by the Tribunal. The department filed a Special Leave Petition (CC 3095-96) against the order in which the delay was condoned and special leave petitions were dismissed on 12.7.1996. The

order passed by the High Court dated 18.7.1995 is quoted as below:-

> *"Income Tax Application No.39 of 1993*
> *The Commissioner of Income Tax (Central), Kanpur v. M/s Kothari Products Ltd., Kanpur.*
>
> *By the Court*
> *Shri Rakesh Ranjan Agarwal for the Revenue.*
> *None appears for the opposite party.*
> *This is an application under Section 256 (2) of the Income Tax Act. Having heard learned counsel Shri Rakesh Ranjan Agarwal and perusing the application, we are of the opinion that no question of law arises out of the order passed by the Tribunal.*
> *The application is, therefore, rejected.*
>
> *Dt.18.7.1995*
>
> *Sd/B.M. Lal*
> *Sd/S.N. Saxena"*

7. The order passed by the Supreme Court in Special Leave Petition (CC 3095-96) dated 12.7.1996 against the order dated 18.7.1995 of the High Court is quoted as below:-

> *"Delay condoned.*
> *The Special Leave Petitions are dismissed."*

8. Learned counsel appearing for the revenue submits that questions were not properly presented before the High Court. The High Court without going into the merits of the case held that no question of law arises from the order of the Tribunal. The basic issue as to whether Zarda Yukta Pan Masala is tobacco preparation or not has been left undecided. There are several judgments on the issue, which require consideration by the Court.

9. Learned counsel appearing for the revenue submits that mere dismissal of Special Leave Petition by the Supreme Court does not amount to affirmation of the decision. He relies upon Navab Sir Meer Osmal Ali Khan v. Commissioner of Wealth Tax, Hyderabad, 162 ITR 888 that the jurisdiction of the

Supreme Court under Art.136 is discretionary and dismissal of a Special Leave Petition cannot be construed as an affirmation by the Supreme Court. He submits that each assessment year in income tax is separate year and even if the question has been considered in the previous year, if there is no decision on merits by the High Court the matter may be considered, when it is appropriately raised and questioned. The revenue has relied upon Indian Steel and Wire Products Ltd. v. Commissioner of Income-tax, West Bengal-I, 108 ITR 802 in which while considering the use of the word 'metal' in conjunction with 'iron and steel' in Item no.1 of Schedule V of the Act it was held that iron and steel can be treated upto a certain stage as raw material, which can take several shapes. But there comes a stage, when by further processing or manufacture its ceases to be a raw material and enters into a category of finished products and therefore iron and steel (metals) has to be considered separately as thing or an article, but articles made or produce from such a thing or an article cannot come within the same item. Other items in the schedule namely steel castings and forgings are product of iron and steel yet they have been separately itemized in the schedule.

10. The revenue has relied upon CIT, Kerala-II v. West India Steel Com. Ltd., 108 ITR 601 in which the Kerala High Court held that M.S. rods and steel sections are basically iron and steel; and in Ramavatar Budhaiprasad v. Assistant Sales Tax Officer, 12 STC (SC) in which it was held that the word 'vegetables' must not be construed in any technical sense nor the botanical point of view but in common parlance. In CST v. Jaswant Singh Charan Singh, 19 STC 469 (SC) the Supreme Court held that the word 'charcol' should be ordinarily understood as included in the expression 'coal'. In Avadh Sugar Mills Ltd. v. Sales Tax Officer, 31 STC 461 the

Supreme Court held that 'ground nuts' come within the item 'oil seeds'.

11. It is submitted that no one unless he is addicted to tobacco, will consciously consume the product. The presence of tobacco in Pan Masala not only changes the flavour but also its contents and usage. A person not addicted to tobacco will suffer from nausea and giddiness in consuming tobacco. The addition of tobacco, to the extent of 4% in the product, makes it a product, which is not bought and consumed as sada, or plain pan-masala. The sada pan masala is separate and distinct product than the Zarda Yukta Pan Masala, which will fall in Item-2 of Schedule XI as tobacco preparation. The assessee, therefore, was not entitled to deduction under Section 80I. The High court on the earlier occasion, did not consider the question and since there was no discussion on merits at all nor there was any indication as to whether the High Court had applied its mind on merits, the Supreme Court dismissed the special leave petition. In the circumstances, a large scale tax evasion has resulted giving benefit of deduction under Section 80I on the income out of manufacture of Zarda Yukta Pan Masala.

12. Shri V.B. Upadhyaya, learned counsel appearing for the respondent-assessee submits that once a question has been decided, whether rightly or wrongly, by the High Court even if no reasons are given, and the Supreme Court did not interfere with the order, the taxing authorities must interpret the provisions in favour of the assessee. The High Court cannot question the orders passed by the Supreme Court and thus the judicial discipline requires that these appeals should be dismissed.

13. Shri Upadhyay relies upon State of Orissa v. Radheyshyam Gudakhu Factory, 1988 (68) Sales Tax Cases 92 in which the Supreme Court held as follows:-

"Serial No.35 of the Schedule to the Orissa Sales Tax Act, mentioned "tobacco" as defined in section 2 (c) of the Additional Duties of Excise (Goods of Special Importance) Act, 1957 as an item entitled to exemption from tax under that Act for the period from July 1, 1967. The entry continued in force up to March 31, 1968. The expression "tobacco" as defined in section 2 (c) of the Additional Duties of Excise (Goods of Special Importance) Act, 1957 has the meaning given to it in item 9 of the First Schedule to the Central Excises and Salt Act, 1944 set out in the following items:

"Tobacco" means any form of tobacco, whether cured or uncured and whether manufactured or not, and includes the leaf, stalks and stems of the tobacco plant, but does not include any part of a tobacco plant while still attached to the earth."

The assessee in these appeals dealt in a product called "gudakhu". They did not include the turnover of "gudakhu" in their assessment return under the Orissa Sales Tax Act and under the Central Sales Tax Act, although they were entering into internal and inter-State sales. They took the stand that both categories of sales of "gudakhu" were exempt from tax under the two enactments, and relied on serial No.35 of the Schedule to the Orissa Sales Tax Act. The Sales Tax Officer levied sales tax on the turnover of "gudakhu" both under the State and the Central Sales Tax Acts, but the assessments were annulled on appeal by the Assistant Commissioner of Sales Tax. The appellate order was upheld by the Tribunal and the Tribunal, at the instance of the Revenue, referred the following questions of law to the High Court:

"(i) Whether, 'gudakhu' is covered by the expression, 'tobacco' as defined in section 2 (c) of the Additional Duties of Excise (Goods of Special Importance) Act, 1957 which was substituted with effect from July 1, 1967, by Notification No.21278-F dated June 6, 1967 and is exempted from tax under the Orissa Sales Tax Act, 1947?

(ii) Whether 'gudakhu' is not taxable under the Central Sales Tax Act, 1956 during the period 1967-68 as per the provision contained in section 8 (2A) of the Central Sales Tax Act, 1956?

As mentioned earlier, the High Court answered those questions in favour of the assessee and against the Revenue. Hence these appeals.

We have heard learned counsel for the parties and we are satisfied that the High Court is right. It appears that "gudakhu" is a product of tobacco and that although a major part of molasses and other constituents are added to the tobacco the essential and effective ingredient remains tobacco, and therefore "gudakhu" is known as a product of tobacco in common parlance. The High Court has referred to "gudakhu" as a form of smoking tobacco and has observed that even though it is also used as a paste for cleansing the gums of the teeth, it would still be regarded as a product of tobacco. We may point out that the Calcutta High Court in Gulabchand Harekchand v. State of West Bengal (1985) 59 STC 224; 23 ELT 306 has also held that "gudakhu" is manufactured out of tobacco and that its essential character is that of a tobacco product even though molasses and other constituents are added to the tobacco and that it is commonly used for cleansing the teeth. We are satisfied that "gudakhu" is a product which falls within the exemption covered by serial No.35 of the Schedule to the Orissa Sales Tax Act and that the High Court is right in holding that the assessee in these appeals are entitled to that exemption."

14. The order passed by the Supreme Court dated 18.7.1995 dismissing the special leave petition against the judgment of this Court is a non-speaking order and which does not show that the matter was considered on merits. Similarly the order passed by the High Court also does not show that any question was raised or considered. It was only an opinion of the High Court that no question of law arise, which was upheld by the Supreme Court. The question still remain undecided. In V.M. Salgaokar & Bro. Pvt. Ltd. v. CIT, (2000) 5 SCC 373; Kunhayammed v. State of Kerala, (2000) 6 SCC 359; U.P. State Road Transport Corporation v. Omaditya Verma, (2005) 4 SCC 424; Satrucharla Vijaya Rama Raju v. Nimmaka Jaya Raju, (2006) 1 SCC 212, the Supreme Court held that the dismissal of the Special Leave Petition in limine does not

operate as confirmation of the reasoning in the decision sought to be appeal against. Such an order does not constitute law.

15. The deduction under Section 80I is provided on the income from the manufacture of the articles other than articles or thing in the Schedule XI and which includes in Entry-2; 'tobacco and tobacco preparations, such as cigars and cheroots, cigarettes, biries, smoking mixtures or pipes and cigarettes, chewing tobacco and snuff'. Pan Masala is not a mixture of tobacco but when it is mixed with tobacco, it becomes a tobacco preparation. In State of Orissa v. Radheshyam Gudakhu Factory (Supra), the Supreme Court held that 'gudakhu' is product of tobacco, and that although a major part of molasses and other constituents are added to the tobacco the essential and effective ingredient remains tobacco, and therefore 'gudakhu' is known as a product of tobacco in common parlance. The Supreme Court upholding the order of the High Court in which 'gudakhu' was referred as form of smoking tobacco held that even though it is used as paste for cleansing the gums of the teeth, it would still be regarded as a product of tobacco, which falls within the exemption covered by Serial No.35 of the Schedule of the Orissa Sales Tax Act.

16. We are unable to appreciate as to how this judgment in State of Orissa v. Radheshyam Gudakhu Factory (Supra) will help the assessee. The Supreme Court in this case was concerned with the meaning given to the word 'tobacco' in Item 9 of the First Schedule of Central Excise and Salt Act, and not 'tobacco preparation' and held that 'gudakhu' is tobacco preparation and thus not exigible to tax in Item 9 of the First Schedule to the Central Excise and Salt Act.

17. In the present case we are concerned as to whether 'Zarda Yukta Pan Masala' is a tobacco preparation. The percentage of tobacco in the mixture, is not material, in as much as once tobacco is mixed, even in a small quantity, the

Pan Masala becomes a tobacco preparation, which is a separate and distinct commercial commodity and clearly identifiable to the consumers, who are addicted to tobacco.

18. In Item No.1 of the list of articles or thing in Schedule XI, the items include beer, wine and other alcoholic spirits. The percentage of alcohol in the spirits is not given. With the same object the percentage of tobacco is also not given in 'tobacco preparation'.

19. In Item No.2 the words 'such as' are indicative and inclusive and do not complete the list of tobacco preparations. For example cigarettes, biries and smoking mixtures for pipes and cigarettes, chewing tobacco and snuff are also tobacco preparations and not tobacco by itself. A variety of ingredients can be mixed together to form a tobacco preparations. The object of entry, is apparently to exclude rebates on manufacture of products, which are dangerous to health.

20. In J.K. Synthetics Ltd. v. Commissioner of Income-Tax, Kanpur, 1981 (130) ITR 23 (SC) The Supreme Court was of the opinion that the question as to whether Nylon-6 is petro-chemical is a question of fact and not a question of law. In a said case the Tribunal held that Nylon-6 is petro-chemical within the meaning of Entry 18 of 5th Schedule to the Act. The High Court had called for a reference on the question. Before deciding whether the question is question of fact, the Supreme Court had examined the findings of the Appellate Tribunal and held that it was not satisfied with the findings and thereafter held that the question had become academic as it had acquired finality.

21. For the aforesaid reasons, the question of law is decided in favour of the revenue and against the respondent assessee. The income tax appeals and income tax reference are **allowed.** The department will proceed accordingly.

Dt.16.10.2012
SP/