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COMPLEXITIES OF ALCOHOL TAXATION IN INDIA: A CONSTITUTIONAL AND JUDICIAL ANALYSIS

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COMPLEXITIES OF ALCOHOL TAXATION IN INDIA: A CONSTITUTIONAL AND JUDICIAL ANALYSIS

Yug Raman Srivastava* & Raman Nagpal**

Abstract

The subject of state duty on alcohol in India is still an unresolved legal and economic problem influenced by the constitution, case law, and policy considerations. Even though the government earns $35 billion annually, its alcohol regulation is fragmented because it can regulate the activity.[1] *Under entry 8 of the State List, the states can make laws on alcohol. On the other hand, industrial alcohol falls within the central government's authority under entry 52 in the Union List.*[2] *Judicial decisions have been decisive in outlining the authority of state governments to levy the tax over the years, from the Synthetics and Chemicals v. State of UP (1990) case, which was the first one to limit state taxation near the point of production of industrial alcohol.*[3] *It is important to remember that though the tax on alcohol is not in GST, the introduction of excise duty on the production of inputs has added costs to the manufacturers, thus causing inefficiencies in their companies.*[4] *Moreover, factors like tax pass-through, cross-beverage substitution, and the illicit liquor market highlight the unintended outcomes of having such a piecemeal taxation policy.*[5]

This paper is a detailed analysis of the legal and economic aspects of alcohol taxation in India and includes an analysis of the lacunas in the existing legal framework.[6] *The paper demands the establishment of a taxing program to achieve*

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[1] The Constitution of India, 1950, Sch. VII, List II, Entry 8

[2] The Constitution of India, 1950, Sch. VII, List I, Entry 52.

[3] Synthetics and Chemicals Ltd v. State of UP, (1990) 1 S.C.C. 109.

[4] Comptroller and Auditor General (CAG), STATE EXCISE AND ALCOHOL TAXATION: POLICY CHALLENGES AND REVENUE IMPLICATIONS (2022).

[5] NITI AAYOG, CROSS-BEVERAGE SUBSTITUTION AND PRICE ELASTICITY IN ALCOHOL CONSUMPTION (2023).

[6] MINISTRY OF FINANCE, REPORT ON ALCOHOL TAXATION AND FEDERALISM IN INDIA (GOVERNMENT OF INDIA, 2023).

financial and other objectives.[7] *Thus, both the utilisation of revenues and welfare would be guaranteed.*[8]

Keywords: Tax; Alcohol; Constitution; Direct Tax; Indirect Tax; GST

I

Introduction

The tax regime for alcohol in India represents a distinctive overlap between constitutional regulations and economic and fiscal governance policies. Although alcohol generates significant revenue, it is excluded from Goods and Services Tax (GST) taxation; instead, it faces a complex array of state excise duties, value-added tax (VAT), and production input levies.[9] Under Entry 8 of the State List, the Indian Constitution permits states to make laws about alcohol regulation, but industrial alcohol control remains a federal responsibility, which leads to jurisdictional disputes.[10] The fragmented regulatory framework created taxation policy inconsistencies, leading to legal uncertainties and economic inefficiencies.[11] The recent regulatory changes reignited discussions about ENA taxation, which applies to industrial use and drinkable consumption and has increased regulatory complexity.[12] Since alcohol is not included in the GST framework, manufacturers face substantial cost burdens because they cannot apply Input Tax Credits to their taxable raw materials.[13] The economic effects of alcohol taxation extend well beyond legal issues and present profound financial consequences.[14] The fragmented taxation policies produce unintended effects, which are evidenced by price elasticity dynamics, cross-beverage substitution patterns, and widespread illicit market

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[7] International Monetary Fund (IMF), TAXATION OF ALCOHOL IN FEDERAL STRUCTURES: LESSONS FOR INDIA (2023).

[8] World Bank, TOWARDS A UNIFIED AND TRANSPARENT ALCOHOL TAXATION SYSTEM IN INDIA (2023).

[9] The Constitution of India, 1950, Sch. VII, List II, Entry 8.

[10] The Constitution of India, 1950, Sch. VII, List I, Entry 52.

[11] Ministry of Finance, REPORT ON ALCOHOL TAXATION AND FEDERALISM IN INDIA (Government of India, 2023).

[12] GST Council, DISCUSSION ON TAXABILITY OF EXTRA NEUTRAL ALCOHOL (ENA) (2023).

[13] Comptroller and Auditor General (CAG), STATE EXCISE AND ALCOHOL TAXATION: POLICY CHALLENGES AND REVENUE IMPLICATIONS (2022).

[14] Reserve Bank of India, ECONOMIC IMPACT OF ALCOHOL TAXATION IN INDIA (2023).

activities.[15] The existence of prohibition laws in certain states stimulates black market activities, which undermine regulatory effectiveness.[16] This paper critically examines the constitutional, judicial, and economic aspects of alcohol taxation within the Indian context.[17] The paper supports establishing a taxation system that maintains state revenue requirements while ensuring legal and economic uniformity to create a fair and transparent regulatory system.[18]

II

Constitutional and Legislative Framework

The constitutional jurisprudence surrounding the status of alcohol is complex and has gone through years of judicial interpretation. The legal battle to give recognition of the right to consume[19] liquor and the exclusive right to trade[20] has been one of the contentions. The unique status of alcohol is evolving due to its fluid matrix; however, at the same time, it is the major revenue-generating commodity for the Indian economy of all the states, with an annual revenue of $35 billion. The Indian constitution has provided dual authority to the state and central governments to make laws on the subject of alcohol; however, the provisions in the directive principles of state policy and the constitution framework give the jurisdiction to states to create policies of public health to shape policies rather than the central government and the exclusive power.[21] Given to the state under entry 8 of the state list in the 17th schedule to make laws for the manufacturing, sale, and consumption of alcohol, which has caused legal debate on the same.

The key area of dispute between central and state governments has been regulating and taxation of alcohol, specifically due to the classification of taxable categories, such as RS and ENA.[22] The question of law has been debated since the

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15 NITI Aayog, CROSS-BEVERAGE SUBSTITUTION AND PRICE ELASTICITY IN ALCOHOL CONSUMPTION (2023).

16 Ministry of Home Affairs, PROHIBITION LAWS AND THEIR IMPACT ON THE ILLICIT ALCOHOL MARKET (2023).

17 International Monetary Fund, TAXATION OF ALCOHOL IN FEDERAL STRUCTURES: LESSONS FOR INDIA (2023).

18 World Bank, TOWARDS A UNIFIED AND TRANSPARENT ALCOHOL TAXATION SYSTEM IN INDIA (2023).

19 State of Bombay v. F.N. Balsara, AIR 1951 SC 318.

20 Khoday Distillers Ltd v. State of Karnataka, (1994) 6 SCC 468.

21 Ibid

22 Raghavan Rama Badran & Sahana Rajkumar, Taxing Alcoholic Spirits in India: The Litmus Test of Potability (International Tax Review, 20 April

GST regime (1990), which was resolved in the post-GST regime in 2024. Alcohol, which has an evolutionary nature in the legal field, requires diligent policymaking for its uniform governance. The legislative provisions for alcohol taxation also vary among states concerning excise duty, value-added tax, etc. However, the authority and power of the state to levy the tax on industrial alcohol has the potential to be used to manufacture potable liquor.[23]

Judicial Interpretation

The judicial interpretation first occurred in 1990 in the case of *Synthetics and Chemicals* v. *State of UP*.[24] The apex court concluded that industrial alcohol, unsuitable for human use, cannot be subject to value-added tax and other taxes. Thus, in the above-said case, it was held that the state doesn't have the authority to levy tax on alcohol and that right vests with the centre; the same line of reasoning was reaffirmed in the case of *State of U.P* v. *Modi Distillery*.[25] In its ratio, this also clarified that until the categorisation of alcohol is under human use, the authority is with the centre. However, in the case of *Bihar Distillery* (1997), the constitutional interpretation changed.[26] The court explained the concept of exceptional spirits within industrial alcohol, which was fit for human consumption and thus taxable, by which the states were granted the authority to levy a state-wide tax on alcohol. This judgment had widespread legal repercussions in the tax jurisprudence of alcohol, and the same has been supported by the upcoming judgments that were referred to the larger bench of the apex court, in the judgment of Deccan Sugar and Abkari Co Ltd vs Commissioner of Excise, App.[27] The court upheld the validity of the principles laid down in the synthetics and chemical judgment without overruling the decision in the Bihar Distillery. [28] Finally, on 23rd October 2024, in the case of State of U.P vs Lalta Prasad Vaish,[29] the Supreme Court of India gave its 9-bench judgment on the issue of whether the state governments can regulate the sale and distribution of industrial alcohol and ruled the judgment in the ratio of 8:1 where in the majority judges held that the entry 8 of state list is inclusive of all the aspects of intoxicating liquor. The bench also clarified the dual effect of entry 52 of the union list, which is read with entry 8. The court has reaffirmed that the states can levy the tax on potable alcohol that is for human consumption the judgment has

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2022) https://www.internationaltaxreview.com/article/2a6ab6uyjg7ixq70ge1og/taxing-alcoholic-spirits-in-india-the-litmus-test-of-potability accessed 20 February 2025.

[23] Ibid

[24] Synthetics and Chemicals Ltd v. State of Uttar Pradesh, (1990) 1 SCC 109.

[25] State of U.P. v. Modi Distillery, (1995) 5 SCC 753.

[26] Bihar Distillery and Anr. v. Union of India, (1997) 2 SCC 727.

[27] Deccan Sugar and Abkari Co. Ltd. v. Commissioner of Excise, AP, (1997) 3 SCC 272.

[28] State of U.P. v. Lalta Prasad Vaish, 2024 INSC 812.

[29] Ibid

also distinguished between denatured and rectified spirit and reasoned that the state could not tax the rectified spirit as it is in the ambit of industrial purpose and potable uses and even the denatured alcohol remains under the jurisdiction of the central government and the stets cannot levy excise duty on it. The judgment has reiterated the stance on GST that alcoholic liquor for human consumption is outside the ambit of GST. This judgment has overruled the verdict in synthetic and chemical vs. the State of UP, which held that intoxicating liquor under entry 8[30] refers only to potable alcohol, which limited the taxation power of the state. This judgment has also provided the broader and inclusive jurisprudential quotient of intoxicating liquor under entry eight, thereby expanding fiscal federalism in the nation.

III

Taxation of alcohol in India: GST Exclusion and Excise Duty Challenges

Excise Duty and Paradox of Alcohol Taxation Post GST

The Goods and Services Tax (GST) has excluded its ambit from the alcohol for human consumption[31]And according to Article 366(12A)[32] The Indian Constitution laid down the principle of exclusion of taxes from the supply of alcohol for human consumption. CGST Act 2017[33] Section 5 of the IGST Act 2017, GST is not levied on the supply of alcohol liquor for human consumption. However, the licensing fees for alcohol remain taxable. The GST now only applies to the ingredients used in making consumable liquor and not to the output of human liquor.[34] The alcohol has two distinct categories for charging GST, these are domestically produced and Indian-made foreign liquor. Even though alcohol has been excluded from the ambit of GST, the import levied and the final tax levied have increased the price of foreign imported liquor.

The excise duty, which is levied on the production of liquor for human consumption, is usually imposed on the licensing, production, and sale of goods.[35] Post GST, excise rates were replaced with GST rates, but the excise duty remains the state's authority. The state legislature holds the authority to regulate and impose the

[30] Ibid
[31] 'GST on Alcohol: Why Liquor Remains Outside GST and Current Taxation' (Busy, 2024) https://busy.in/gst-rates/alcohol/ accessed 8 July 2025.
[32] The Constitution of India, 1950, s. 366(12A).
[33] Central Goods and Services Tax Act, s. 5.
[34] Integrated Goods and Services Tax Act, 2017, s. 5.
[35] Tiwari (n 1).

levy on alcohol for human consumption. The excise collection as a percentage of production has been fluctuating over the years from 160% in 2011-12 to 266% in 2020-21. [36]According to official government records, there has been a progressive taxation approach with the increasing excise duties at a higher rate than the production growth. The state's excise collection strongly depends on the consumption expenditure and is a key determinant of overall tax collection.[37] There is a non-linear relationship between consumption and the total excise duty collected as there is a causal and direct relationship between the three economic determinants of taxation, which are consumption, state excise collection, and expenditure all these three determinants have a positive relation as one increases the other one also increases however after reaching a fixed point the graph tends to move downwards. According to research, when the per capita income is higher, and the consumers have a higher economic capacity, it may induce consumer behaviour to spend more on discretionary consumption of alcohol, which also leads to the consumption of higher value alcoholic beverages.[38]

In the same way, the excise collection as a percentage of consumption increased from 160% in 2011-12 to 252% in 2021-22. This explains the shift towards premium alcoholic brands and strict tax mechanisms. This shows the dependence of state governments on tax collection for revenue. The premise that high taxation rates on liquor may contribute to an increase in the price of liquor should not be denied now. It should also be noted that in addition to state excise duty, most Indian states also collect value-added tax on alcoholic beverages. The VAT is also a type of indirect tax levied on alcohol. However, it is imposed on the output of the alcohol produced, which varies from state to state.

The taxation Dilemma of Extra Neutral Alcohol (ENA)

The tax on ENA is a vital cause of debate in the taxation of alcohol due to its dual usage for both potable and industrial use[39]. The alcohol for human consumption is exclusively taxed by the states, even after several meetings, the GST council has held multiple discussions to address the taxability of ENA.[40] And recognising the proportions of ENA in both Indian Made Foreign liquor and Indian Made liquor (IML). The 52nd GST Council meeting recommends that ENA be designated to be

[36] Sacchidananda Mukherjee & Shivani Badola, REVENUE MOBILISATION FROM TAXES ON ALCOHOLIC BEVERAGES (National Institute of Public Finance and Policy, 2024) https://www.nipfp.org.in/publications/working-papers/2018/ accessed 24 January 2024.

[37] Ibid

[38] Ibid

[39] Taxmann, TAXMANN (2025) https://www.taxmann.com/ accessed 28 January 2025.

[40] Ibid

excluded from GST when used in the manufacturing of beverages for human consumption, reflecting the constitutionality of the provisions to grant the states the authority to tax such inputs of goods thus, this recommendation of ENA exclusion (when it is used for alcohol production) might resolve the issue by reducing the tax complexities and costs.

Economic and Industrial Impact of GST Exclusion

The liquor industry has constantly been demanding the inclusion of alcohol under GST. The said industry has argued that the exclusion of alcohol from this taxable category has led to an overall increase in production expenditure as the ingredients and elements required during the production of alcohol are taxable but, at the same time, cannot claim the benefit of Input tax credit (ITC) on the final output. The alcohol manufacturing industry faces costs even on internal expenses like logistics, bottling, packaging, etc. For instance, in the case of the tax cost sheet, the example of Maharashtra and Andhra Pradesh in terms of label charges varies a lot, with Maharashtra reflecting a cost of 18 crore and Andhra Pradesh 5 crore, which shows the stark difference and non-uniformity in the system.[41]

According to tax expert Dr Sanjiv Aggarwal, the GST poses multifarious challenges to alcoholic beverages. In the GST regime, higher GST liability on several elements of raw materials used in ethanol production in alcohol causes a financial burden on the manufacturers. The lack of centralised registration in GST is also a cause of confusion; the GST has a ripple effect on the final pricing of the product, as, in these cases, no tax credit is available between GST and excise tax. In such a scenario, production costs rise, and consumer prices become unfriendly.[42] The GST poses another risk regarding its rates on input materials and services; the costs get significantly higher, leading to detrimental effects on the industry. The manufacturers of alcoholic beverages for human consumption procure the inputs through captive manufacturing and by way of purchase from third parties in India, or by import. In these cases, as the finished product remains outside the GST, it negatively affects state revenue and makes the final consumable product expensive.

Another issue concerning the taxation of alcohol is the reused bottles and VAT. Some manufacturers also use exclusive e-patented bottles, which have the inherent capacity to be used 5-7 times by the same manufacturer. Many states impose lower VAT rates, while VAT is applied to the finished products that are to be sold within

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[41] Anurag Mundara, Impact of Alcohol Tax on Externalities Associated with It, 6(6) INT'L J. ADV. RES. IDEAS & INNOV. TECH. (2020) <www.ijariit.com> accessed 20 January 2025.
[42] Alcohol Taxation in India: Challenges and the Way Forward' (Tax Management India, 24 September 2020) http://taxmanagementindia.com/ accessed 29 January 2025.

the state. This also leads to dual taxation when the used bottles are taxed again. This issue of double taxation, where the first VAT is charged on used bottles at the full and original purchase price, leads to double taxation. This leads to an overall increase in alcohol manufacturers.

Why Is Alcohol Kept Out of GST? Apart from this, alcoholic liquor for human consumption is not covered under Article 366(12A), whereas on industrial alcohol, 18% GST is levied.[43] The 268th Report of the Law Commission of India (2017) recommended alcohol taxation under GST to prevent evasion, but the states refused to preserve their revenue autonomy.[44] Moreover, Cauvery Sugar & Chemicals Ltd. v. State of Karnataka (1994) lays down the states' prerogatives over liquor taxes without considering revenue efficiency.[45]

The Financial Black Hole of GST Exclusion: The Finance Ministry (2019) estimated that including alcohol under GST at 28% (highest slab) + additional cess could generate ₹1.75 lakh crore annually, a revenue surplus even after compensating states.[46] A joint FICCI-CRISIL study (2022) showed that the black-market liquor trade, fuelled by tax disparities, costs India ₹50,000 crore in lost revenue annually.[47] In contrast, countries like the United Kingdom tax alcohol under Value Added Tax (VAT) + Excise Duty, simplifying compliance,[48] While Australia imposes excise duty based on alcohol percentage, it prevents manufacturers from tweaking alcohol content for tax benefits.[49] India's GST exemption incentivises under-invoicing, illegal interstate transport, and tax manipulation, yet the strict measures have not been initiated.

State-Wise Taxation Chaos: The Price Gamble That Encourages Crime

The ₹600 Price Gap: How Tax Arbitrage Fuels Illegal Trade: A bottle of Blenders Pride (750ml) costs ₹850 in Chandigarh (lowest excise duty), ₹1450 in Maharashtra (highest excise duty), ₹1,100 in Delhi, ₹1,200 in UP and ₹1,300 in West Bengal and

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43 The Constitution of India, 1950, art. 366(12A).

44 Law Commission of India, ASSESSMENT OF STATUTORY FRAMEWORKS OF TRIBUNALS IN INDIA (Report No 268, 2017).

45 Cauvery Sugar & Chemicals Ltd v. State of Karnataka, (1994) 2 SCC 498.

46 Ministry of Finance, Government of India, GST REVENUE ESTIMATION REPORT (2019).

47 Federation of Indian Chambers of Commerce & Industry & CRISIL, STUDY ON ILLICIT ALCOHOL MARKET IN INDIA (2022).

48 HM Revenue & Customs, VAT ON ALCOHOLIC DRINKS (UK Government, 2023) https://www.gov.uk accessed 3 February 2025.

49 Australian Taxation Office, EXCISE DUTY RATES FOR ALCOHOL (Australian Government, 2023) https://www.ato.gov.au accessed 3 February 2025.

an arbitrary cess by states.[50] Low taxes in Haryana incentivise bulk buying for resale in Punjab and Delhi, while the duty-free state of Goa leads to liquor smuggling into Maharashtra.[51]

Excise Duty Manipulation: The Hidden State Tax Strategy: Karnataka does not levy excise duty on alcohol content, leading to an inflation of the prices on liquor price slabs of the premium brands.[52] Moreover, Tamil Nadu and Kerala also impose a 'Special levy', such as Tamil Nadu's'Health Cess' (₹10 per bottle) and 'Luxury Tax' of 35% applied on imported liquor in Kerala, leading to the bootlegging of more foreign brands.[53]

The 'Corona Cess' That Never Left: Uttar Pradesh, Maharashtra, and Tamil Nadu continue to levy a 'COVID-19 Liquor Cess' introduced during the pandemic.[54] There is no public audit on where the funds of ₹3,600 crore that the Uttar Pradesh government collected from the cess (2020-22) went.[55] States can arbitrarily alter taxation without a national excise framework and create legal loopholes, leading to consumer exploitation.[56]

Classification Loopholes: Taxing the Same Product Differently

The 'Caramel Popcorn Case' and Its Impact on Alcohol Taxes: In ITC Ltd. v. Commissioner of Central Excise (2019), the Supreme Court ruled that popcorn with caramel cannot be classified as a confectionery because of its unique composition.[57] The same rationale lets manufacturers tweak alcohol percentages to make it into the next lower tax category.[58] For example, alcopops were taxed as soft drinks in some

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[50] Centre for Policy Research, STATE-WISE LIQUOR PRICING AND TAXATION TRENDS IN INDIA (2023).

[51] Federation of Indian Chambers of Commerce & Industry, IMPACT OF STATE TAX POLICIES ON THE LIQUOR INDUSTRY (2022).

[52] Karnataka Excise Department, EXCISE DUTY AND ALCOHOL TAXATION POLICY (Government of Karnataka, 2023).

[53] Kerala State Beverages Corporation, LUXURY TAX AND SPECIAL LEVIES ON ALCOHOL (Government of Kerala, 2023).

[54] Ministry of Finance, Government of India, STATE-WISE LIQUOR TAXATION AND COVID-19 CESS REPORT (2023).

[55] Comptroller and Auditor General of India, AUDIT REPORT ON REVENUE RECEIPTS OF UTTAR PRADESH, 2020-2022 (2023).

[56] Federation of Indian Chambers of Commerce & Industry, EXCISE TAXATION AND LIQUOR INDUSTRY REFORMS IN INDIA (2022).

[57] ITC Ltd v. Commissioner of Central Excise, (2019) 9 SCC 780.

[58] Ministry of Finance, Government of India, INDIRECT TAXATION REPORT ON ALCOHOLIC BEVERAGES (2023).

states, while states such as Maharashtra and West Bengal tax beer and spirits by different methods, resulting in classification loopholes.[59]

The Excise Duty Illusion on Wine & Hybrid Alcohol: Maharashtra imposed no excise duty on domestic wines but did charge a 300% equivalent duty for imported foreign wines.[60] This goes against the WTO terms of liberalising trade barriers.[61] The alcoholic drinks made from fruit, such as grass, cider, and mead, belong to another category in some states.[62]

High Tariffs, Smuggling, and WTO Disputes: Unravelling India's Alcohol Policy

India's Protectionist Alcohol Policy: Smuggling and illicit production of alcohol are major issues within India, but they are also significant concerning Indian trade abroad. With a high import duty of 150-200%, India makes imported liquor 2-3 times more expensive than it costs in countries where international markets are found.[63] This provides an incentive for smuggling, and approximately 40% of duty-free alcohol sales in places like Dubai, Malaysia, and Nepal are to Indian nationals due to the high taxes on imported liquor levied by India.[64] Domestically, smuggling is also prominent in certain states. It is estimated that in the 1st year of the alcohol ban in Bihar, approximately INR 4,000 crores worth of alcohol were smuggled across borders.[65] A combination of factors contributes to this situation, such as a lack of consumer information, non-implementation of the regulations, and intrinsic tax differences, which make illicit alcoholic beverages cheaper.[66] In addition, restrictions on access to legitimate liquor led to the illegal production and consumption of alcohol, especially in states like Bihar, Gujarat, Nagaland, and Mizoram, as well as

[59] Federation of Indian Chambers of Commerce & Industry, STATE-WISE ALCOHOL TAXATION AND CLASSIFICATION DISPARITIES (2022).
[60] Maharashtra Excise Department, EXCISE POLICY AND DUTY STRUCTURE ON ALCOHOLIC BEVERAGES (2023).
[61] World Trade Organization, GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) 1994, art. III:2.
[62] Ministry of Finance, Government of India, ALCOHOLIC BEVERAGE TAXATION AND CLASSIFICATION REPORT (2022).
[63] Ministry of Finance, Government of India, IMPORT DUTY STRUCTURE ON ALCOHOLIC BEVERAGES (2023).
[64] Federation of Indian Chambers of Commerce & Industry, IMPACT OF HIGH IMPORT DUTIES ON ALCOHOL TRADE (2022).
[65] Bihar Excise Department, REPORT ON ALCOHOL PROHIBITION AND SMUGGLING IN BIHAR (2022).
[66] Comptroller and Auditor General of India, AUDIT REPORT ON ILLICIT ALCOHOL TRADE (2023).

the Union Territory of Lakshadweep.[67] Illegally made alcohol lacks the proper manufacturing or trading licenses or an appropriate sanitary permit,[68] and it includes counterfeit goods alongside legitimately branded bottles that have been smuggled out of the country.[69] According to the Euromonitor Global Study on Illicit Alcohol 2018, about 25.8% of total global alcohol consumption comes from illicit sources. This means that one in every four alcohol bottles people drink worldwide is illegal,[70] and also, it has not been taxed or tracked by any government regulatory bodies, so nobody knows where it came from or who made it. As per the World Health Organisation in India, 46% of the alcohol consumed each year is unrecorded.[71] Moreover, as the Organisation for Economic Cooperation and Development (OECD) points out, the profitability of the illegal alcohol trade has attracted organised crime groups.[72]

Legal Challenge: WTO vs. India's Liquor Taxes: The EU & US challenged India at the WTO over 2018 tariffs on imported wine and spirits. It is called protectionist and contrary to WTO principles.[73] The European Communities, i.e., the EU, raised concerns about discriminatory taxation on imported bottled wines and spirits by the Indian states of Maharashtra and Goa and restrictions on retail sales imposed by Tamil Nadu.[74] At the same time, the tax measures of the Maharashtra government contravened Articles III:2 and III:4 of GATT 1994 as well as Articles 3.1(b) and 3.2 of the SCM Agreement.[75] Goa's action also breaches Article III:2 GATT 1994.[76] Provisions like those of Tamil Nadu remittances, which affect the import, transport, and distribution of alcoholic drinks, were also found to depart from Article III:4 GATT 1994.[77] These measures were argued to impact EU exports of wines and spirits

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[67] Ministry of Home Affairs, Government of India, PROHIBITION LAWS AND ENFORCEMENT IN DRY STATES (2023).
[68] World Health Organization, GLOBAL STATUS REPORT ON ALCOHOL AND HEALTH (2018).
[69] Euromonitor International, ILLICIT ALCOHOL TRADE AND COUNTERFEIT LIQUOR MARKET (2018).
[70] Ibid
[71] World Health Organization, GLOBAL STATUS REPORT ON ALCOHOL AND HEALTH (2018).
[72] Organization for Economic Cooperation and Development, ILLICIT TRADE: CONVERGING CRIMINAL NETWORKS (2019).
[73] World Trade Organization, DISPUTE SETTLEMENT: INDIA–ALCOHOL TARIFFS (2018) https://www.wto.org accessed 3 February 2025.
[74] European Commission, EU CHALLENGE TO INDIAN WINE AND SPIRITS TARIFFS (2018).
[75] World Trade Organization, INDIA'S ALCOHOL TRADE POLICIES AND THEIR IMPACT ON EU EXPORTS (2019).
[76] Ibid
[77] Ibid

negatively.[78] This case also runs parallel and resembles the 1996 WTO ruling on the Japanese Liquor Tax Law, in which Japan was found to have violated GATT Article III:2 by practices such as levying domestic taxes to protect its alcoholic beverage domestic industry.[79] The US had previously challenged India's additional duties on alcoholic beverages, leading to a ruling that required India to adjust some of its duties.[80] In response to these challenges, India could reform state-level liquor taxes to ensure non-discriminatory treatment of imported and domestic products, eliminate trade-restrictive measures in Tamil Nadu, and further adjust customs duties within WTO boundaries. By drawing from global precedents and aligning its policies with international rulings, India could reduce the risk of future disputes while maintaining lawful protection for its domestic industry through measures like quality standards and licensing regulations.[81]

IV

Lacuna of Economics in Taxation and Policy Governance

Indian policymakers often use alcohol taxation as a tool for reducing its consumption and mitigating the harms associated with it, as the use of alcohol results in an increase in negative externalities, including health, crime, and loss of productivity. Thus, the Indian government employs taxation to reduce consumption and generate revenue to offset social costs. However, despite this, the effectiveness of this fluid policy is influenced by the cross-beverage substitution and tax pass-through, which will be discussed further.

Negative externalities are when the consumption of a good without direct interference in the transaction imposes costs upon a third party. The externalities have increased significant expenditure in healthcare and lost productivity, etc. Allocating efficiency requires government interference to correct the divergence between the MPB (marginal private benefit) and MSB (Marginal social benefit). The price elasticity of Demand (PED) refers to the degree to which the quantity demanded changes in response to a price change. In India, Kerala has established a unitary elasticity (PED<1) for alcohol, which means that increasing the cost of

[78] World Trade Organization, INDIA'S ALCOHOL TRADE POLICIES AND THEIR IMPACT ON EU EXPORTS (2019).
[79] WTO Appellate Body Report, JAPAN–TAXES ON ALCOHOLIC BEVERAGES (WT/DS8/AB/R, 1996).
[80] Office of the United States Trade Representative, US CHALLENGES INDIA'S ALCOHOL DUTIES AT THE WTO (2019).
[81] WTO Secretariat, BEST PRACTICES IN ALCOHOL TRADE REGULATION: LESSONS FOR INDIA (2020).

alcohol doesn't decrease subsequent consumption. This means the proportional increase in price doesn't reduce the proportional consumption of it. We can infer that the inelastic nature of alcohol consumption can be due to the constant nature of alcohol consumption.

According to the recent research in 2022 on alcohol taxation across central states, a 1 % increase in the price has only led to a 0.057% decline in its consumption. In contrast, a 1% reduction in the tax has reduced alcohol consumption by 0.1475. This suggests that a 10% increase in tax yields an 8.4% increase in revenue for the authorities, showing the revenue-generating model of alcohol taxation in India. The extent of the sin tax on alcohol has been able to generate significant revenue and reduce health care expenses; thus, increasing the rates will not help to create the tax revenue, but at the same time provide social benefits attached to it. Hence, the two tax rates must be evaluated to consider the efficiency of alcohol taxation for several purposes, essentially the revenue-maximising tax rate and the Socially Optimal Tax Rate (SOTR). RMTR is a type of tax that leads to gift revenue tax collection, while SOTR tries to bring equilibrium to the optimum quantity and price of alcohol.

Thus, the intermingling of these two rates is usually not observed. As a result, the sin tax hardly attains both revenue maximisation and the social optimum. The quantity that maximises the benefits is difficult to measure. In economics, the RMTR is often calculated to evaluate the effectiveness of the ad valorem tax in generating tax revenue, which is one of the essential reasons for the imposition of taxes. The government balances revenue maximisation and social welfare through a correct taxation policy. The state of Kerala is a role model for the tax policy in India; the analysis shows that the current tax rate is (0.205), which is lower than the RMTR (0.275), so higher taxes can be levied, the model is further supported by its legal framework like the Kerala Abkhari Act of 1902 which gives more state authority to make robust policies related to alcohol regulation which ensure correct targeting and revenue generation at the same time.

Cross Beverage Substitution

Cross-beverage substitution is an integral part of the economics sphere of Alcohol taxation and remains unexplored; cross-beverage substitution is a phenomenon where the price of a specific type of alcohol increases and leads to a relative increase in the demand for another, often the other one is cheaper. In this, the consumers usually shift from high-taxed alcoholic beverages to lower ones, even though this significantly reduces the expenditure but this might cause havoc in geographies that have a causal link between spirit consumption and crime According to research in 2009, the increase in the demand of spirit liquor which is the result of substitution from highly taxed beverage to lower one lead to net effect on the cumulative consumption but static in terms of redu0ction in the harm associated with it.[82] Thus, in this sense, while the tax increase might reduce alcohol consumption, the substitution effect prompts the consumers to shift quickly. This suggests the need for differential taxation on alcohol, which means a uniform taxation policy that can prevent consumers from immediately moving to alternatives, thus reducing consumption.

Tax Pass-through Rates

Another threat to alcohol taxation as a policy governance is the tax pass-through concept. In this scenario, producers and manufacturers try to pass costly alcohol taxes to consumers at high prices. The tax pass-through varies across several economic conditions, which leads to the full tax burden shifting directly onto the consumers. Several other factors influence the tax pass-through, including the market structure. For instance, if the market is oligopolistic. The large production houses control the whole market, and the pass-through rate is high. This can be linked to the Indian marketing scenario where the tax pass-through varies and price increases more than the tax hike, affecting the consumers on a large scale; however, in a more competitive structure, the producers don't completely shift the tax burden. Consumer preferences, especially in regions like India, where the inelastic demand for alcohol is higher, make it easier for retailers to pass taxes on to consumers.[83]. Research has also found that specific excise taxes are more likely to be passed on to the consumer than ad valorem taxes. To ensure the effectiveness of alcohol taxation governance, policymakers must monitor the pass-through rate properly to ensure that the taxes cause an increase in price and a subsequent decrease.

In several states, the substantial differences in alcohol taxation led to differences in the pricing, and this price disparity leads to illegal production and selling. The producers distribute the alcohol in high-tax regions of the nation. A state-wise comparison indicates that the heavy dependence on alcohol for state revenue leads to the proliferation of the black market. In research conducted by ISWAI, it has been observed that 60%-70% of the taxation accounts leave a margin for the traders, leading to increased criminal activities, including chances of tax evasion.[84]. Additionally, this often promotes black marketing also, as in the case of Gujarat,

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[82] Alexander C. Wagenaar, Amy L. Tobler & Kelli A. Komro, Effects of Alcohol Tax and Price Policies on Morbidity and Mortality: A Systematic Review (2010) 100(11) AM. J. PUB. HEALTH https://doi.org/10.2105/AJPH.2009.186007

[83] Ibid

[84] Raghavan (n 1).

where despite the prohibition on alcohol, there is a thriving black market of unauthorised and unsafe liquor, which leads to misuse of the alcohol policy in India.

V

Towards a Unified & Transparent Tax System

Integrating Alcohol into GST: A Balanced Approach - Introducing in alcohol a 28% GST slab on alcohol with state-specific cess can help achieve revenue neutrality for the states, as long as it is supported through a GST Compensation Fund for states heavily reliant on excise duty.[85] The states such as Uttar Pradesh, Tamil Nadu, and Andhra Pradesh, which rely on taxation revenues from excise duties, necessitate a comprehensive solution to integrate alcohol into GST while preserving fiscal balance.[86] The proposed solution involves a phased integration with a 28% GST slab and state-specific cess, provided that overall revenues remain unchanged, supported by a GST Compensation Fund to ensure states dependent on excise revenues, such as Goa, Maharashtra, and Haryana, will not be disadvantaged.[87] The Fund provides safety nets as temporary revenue guarantees covering 80% of lost excise revenues in 2017, declining gradually over five years. [88]A blockchain-based digital monitoring system would make tax adjustments by monitoring production, distribution, and sales in real time, thus ensuring transparency and compliance.[89] A national unified pricing system, with a price floor based on GST + State cess, will standardise prices, prevent smuggling across borders, and block tax evasion.[90] Small-scale producers such as craft breweries and artisan distilleries will receive exemptions for the first five years or a reduced GST rate to encourage entrepreneurship and innovation.[91] Policies that are environmentally sound, like solar power on-premises or water-saving techniques during production, are rewarded with tax breaks, and rates of cess can be lowered in such cases, which

[85] Ministry of Finance, GST COUNCIL REPORT ON ALCOHOL TAXATION (Government of India, 2023).
[86] Comptroller and Auditor General (CAG), STATE EXCISE REVENUES AND GST: CHALLENGES IN ALCOHOL TAXATION (2022).
[87] GST Council, MINUTES OF THE 45TH GST COUNCIL MEETING (2022).
[88] Finance Commission of India, REVENUE NEUTRALITY IN GST AND STATE EXCISE (2021).
[89] Organisation for Economic Co-operation and Development (OECD), BLOCKCHAIN FOR TAX COMPLIANCE: A CASE STUDY ON ALCOHOL TAXATION (2023).
[90] World Bank, INDIA'S LIQUOR TAXATION SYSTEM: ECONOMIC IMPACTS AND SMUGGLING PREVENTION STRATEGIES (2022).
[91] Ministry of Commerce and Industry, STARTUP INDIA: POLICY INITIATIVES FOR SMALL-SCALE ALCOHOL PRODUCERS (2023).

meets the sustainability ambitions India has in mind.[92] A national education campaign on GST benefits will bring home its advantages, ensuring consumers receive fair prices and producers simplified compliance.[93] Thus, the small-scale producers will be encouraged to bring higher-quality products, ultimately creating a transparent, efficient, and fair system that stimulates local innovation, enhances state autonomy, and modernises India's alcohol taxation framework.[94]

Reclassify Liquor Based on Ethanol Content, Not Arbitrary Branding- It is essential to introduce a unified national classification framework where excise duties are charged based on ethanol content per millilitre (ml) rather than arbitrary branding categories such as 'IMFL' (Indian Made Foreign Liquor), 'country liquor' or 'premium spirits', as this ensures uniformity, and will prevent tax evasion and align India with best international practices.[95] Currently, alcoholic beverages are categorised and taxed differently in many states throughout the country, with categories like country liquor, which is taxed less but with trade restrictions attached, and IMFL (Indian Made Foreign Liquor), which is taxed heavily. At the top, foreign liquor is more costly because of import duties.[96] Beer and wine are often taxed less comparatively.[97] This leads to companies reformulating their products to fit lower tax brackets, such as modifying IMFL to look more like country liquor or exploiting the marked differences in duties levied on lower-alcohol spirits and RTDs to make a profit.[98] A progressive taxation model based on ethanol content would be more scientific and fair, along with implementing a flat rate per ml of ethanol with tiered tax slabs, e.g., 5%-10% ABV for low-alcohol drinks, 11%-20% ABV for moderate, 21%-40% ABV for higher, and above 40% ABV for the highest, and penalties on the dilution manipulation methods,[99] a unified excise duty across states is needed to prevent tax arbitrage, and innovative solution such as AI-based system for confirmation of content-specified spirit strength, sharing platforms using blockchain technology, Smart Excise Duty Tokens (SET) for monitoring in real-time

[92] NITI Aayog, SUSTAINABLE PRACTICES IN THE ALCOHOL INDUSTRY: POLICY RECOMMENDATIONS (2023).
[93] Reserve Bank of India, GST REFORMS AND THEIR IMPACT ON THE ALCOHOL INDUSTRY (2023).
[94] International Monetary Fund (IMF), INDIA'S STATE-LEVEL TAXATION POLICIES AND THEIR FISCAL IMPACT (2023).
[95] Ministry of Finance, REFORMING ALCOHOL TAXATION: A MOVE TOWARDS ETHANOL-BASED CLASSIFICATION (Government of India, 2023).
[96] Comptroller and Auditor General (CAG), STATE EXCISE AND ALCOHOL TAXATION: POLICY CHALLENGES AND REVENUE IMPLICATIONS (2022).
[97] GST Council, REPORT ON ALCOHOL TAXATION AND EXCISE DUTIES (2022).
[98] Organisation for Economic Co-operation and Development (OECD), LIQUOR TAXATION AND EVASION: A GLOBAL PERSPECTIVE (2023).
[99] Reserve Bank of India, IMPACT OF TAX ARBITRAGE ON THE ALCOHOL INDUSTRY: A CASE STUDY (2023).

the payment of taxes, flexible excise duty policy that makes adjustments against if factors change unexpectedly with a single Unitary Digital Liquor Pass (DLP) to prevent black marketing.[100] Global precedents, such as the volumetric taxation system in the UK, Australia's excise duty per litre of pure alcohol, and Japan's recent reforms to equalise duty between beer and spirits, in a similar manner, the application of ethanol-based tax models to India can be expected to provide the desired effects.[101] By disregarding a discredited model based exclusively on brand and from an approach rooted in data and science, India can boost the income of all its states, reduce tax evasion, and create a clearer marketplace for consumers and businesses alike.[102]

Lower Import Duties to Disrupt Smuggling & Boost Revenue - Aligning India's import duties on alcoholic drinks with WTO norms requires reducing them from the current 150-200% rates to 50-75%, which will significantly increase public income, reduce smuggling, and increase government revenue.[103] While India's base import duties on wine are 100% and spirits are 150%, which fall within WTO limits, additional federal and state-level taxes have, in some cases, raised the total tax burden as high as 550% on spirits and 264% on wines, incentivising illicit trade.[104] Last FY, India imported a billion dollars worth of alcoholic beverages, and Britain accounted for $374 million, yet smuggling remains rampant due to the increased tariffs.[105] A differential duty system, low alcohol at low rates, and high alcohol at high rates can encourage legal imports and discourage the demand for illicit spirits.[106] Moreover, adopting a traceability system involving blockchain technology and a real-time checking method with a QR code, just like Brazil's Sistema de Controle de Producao de Bebidas, enables the authentication of imported alcohol and within five years, it reduced smuggling by more than 20%.[107] Finally, based on real-time smuggling heatmaps, satellite tracking, and AI-driven predictive analytics, arrangements for high-risk trafficking routes, such as those discovered by agencies like the Ministry of Finance's Directorate of Revenue Intelligence (DRI), seized over

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[100] NITI Aayog, BLOCKCHAIN AND AI IN EXCISE DUTY COMPLIANCE (2023).
[101] International Monetary Fund (IMF), VOLUMETRIC ALCOHOL TAXATION MODELS: LESSONS FROM THE UK, AUSTRALIA, AND JAPAN (2023).
[102] World Bank, INDIA'S ALCOHOL MARKET: POLICY REFORMS FOR TRANSPARENCY AND EFFICIENCY (2023).
[103] World Trade Organization (WTO), TRADE POLICY REVIEW: INDIA (2023).
[104] Ministry of Commerce and Industry, ANALYSIS OF IMPORT DUTIES ON ALCOHOLIC BEVERAGES (2022).
[105] Reserve Bank of India, ANNUAL REPORT ON FOREIGN TRADE AND IMPORTS (2023).
[106] International Monetary Fund (IMF), INDIA'S ALCOHOL IMPORT POLICY AND MARKET REFORMS (2023).
[107] Brazilian Ministry of Finance, SISTEMA DE CONTROLE DE PRODUCAO DE BEBIDAS: A CASE STUDY (2022).

₹1,200 crore in smuggled liquor fill a further gap.[108] Establishing Special Economic Zones (SEZs) for liquor distribution at large ports and Bonded Warehouses could solve the problem of illegal stocks.[109] A floating tariff system that would adjust import duties depending on the season, trend, and domestic production figures is beneficial to market stability and prevents supply shortages that fuel black-market trade.[110] In border regions with high levels of smuggling, such as Punjab, Assam, and Mizoram, duty-free liquor zones may be set up under strict customs control, allowing travellers to buy legal alcohol while undercutting smuggling networks and finally, making cross-border contract rules on the model of Singapore's Licensed Importer Program that rewards ethical sourcing, serves to streamline customs procedures, and promotes tax compliance for legal alcohol and its manufacturers.[111] With a suitably balanced combination of lowered tariffs, high-grade tracking, and market-based policies that are highly responsive to changing circumstances, they can dismantle illicit liquor trade, ensure regulatory transparency, attract foreign direct investment (FDI), and contribute to India's long-term economic growth.[112]

Standardising Alcohol Taxation, Preserving State Autonomy - The dual taxation issues persist and vary in different states of India. Thus, there is a pressing need for a standardised taxation framework regulating different states while preserving the states' autonomy. However, the Indian Constitution places alcohol under the State List (Entry 51, List II, Seventh Schedule), which confers jurisdiction to the states to levy excise duties on alcohol, leading to the difficulty in maintaining neutrality between different states.[113] Thus, the centre could create a model excise policy through cooperative federalism, where all states voluntarily agree to standardised tax slabs without making any constitutional amendments.[114] The Centre can also classify some alcohol products (e.g., industrial alcohol, wine, ethanol-blended products) under GST while leaving strong liquors under state control.[115] This would

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[108] Directorate of Revenue Intelligence (DRI), ANNUAL REPORT ON SMUGGLING AND ILLICIT TRADE (2023).
[109] NITI Aayog, POLICY FRAMEWORK FOR SEZS IN ALCOHOL DISTRIBUTION (2023).
[110] GST Council, FLOATING TARIFF MODELS FOR IMPORT DUTIES (2023).
[111] Singapore Customs, LICENSED IMPORTER PROGRAM: A MODEL FOR INDIA? (2023).
[112] World Bank, FOREIGN DIRECT INVESTMENT AND REGULATORY FRAMEWORK IN INDIA (2023).
[113] The Constitution of India, 1950, Sch. VII, List II, Entry 51.
[114] Ministry of Finance, REPORT ON ALCOHOL TAXATION AND FEDERALISM IN INDIA (2023).
[115] GST Council, POTENTIAL INCLUSION OF ALCOHOL UNDER GST: POLICY CONSIDERATIONS (2023).

partially unify taxation without fully taking alcohol from the State List.[116] The centre should also remove interstate barriers to create a uniform pricing system.[117]

Conclusion

The issue of alcohol taxation in India is still challenging, including a balancing between constitutional mandates, judicial precedents, economic imperatives, and public policy concerns. The fragmented regulatory structure and the jurisdictional conflicts between the state and the central governments have facilitated the ineffectiveness, revenue leakages, and expansion of the black liquor market. Not including alcohol in the GST framework aggravates existing problems, such as increasing production costs, leading to tax evasion, and fostering smuggling. The decisions of the Indian judiciary have also given pivotal direction to the alcohol tax rate. Still, the variations in taxation policies among states highlight the pressing need for effective and precise reform implementation. Furthermore, the lack of a unified and transparent tax structure has resulted in significant economic distortions, emphasising the need for a comprehensive strategy that addresses economic requirements while generating revenue and protecting societal welfare. To address these issues, the country should consider gradually incorporating alcohol into the GST framework while allowing states to retain autonomy through compensatory measures. Moreover, implementing a classification system based on ethanol content rather than branding, lowering import duties to combat smuggling, and utilising blockchain technology could also greatly enhance transparency and compliance. Additionally, policies must be crafted to reduce tax pass-through effects and cross-beverage substitution, ensuring that taxation meets its goals without causing unintended issues.

In summary, a carefully designed, equitable, and practical taxation policy that aligns with alcohol regulation in India will be vital for the country's progress. By using the systematised method and relying on data, India can not only enhance state revenues but also curb illicit trade, protect consumers, and align its policies with global best practices. The time for piecemeal reforms has passed, and India must now embrace a comprehensive, forward-thinking taxation model that serves both economic and social interests.

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[116] NITI Aayog, COOPERATIVE FEDERALISM AND EXCISE TAX REFORMS (2023).
[117] Ministry of Commerce and Industry, INTERSTATE BARRIERS AND LIQUOR TRADE IN INDIA (2023).