INTERNALISING SOCIAL COSTS VIA ₹2,000 PER LAIB: LEGAL SUSTAINABILITY & ECONOMIC EFFICIENCY UNDER INDIAN TAX LAW

by

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ABSTRACT

This paper analyses the Karnataka government's pioneering shift towards a strength-based excise duty levied per litre of alcohol in beverage (LAIB), with a proposed benchmark of ₹2,000 per LAIB by FY 2028–29. This reform, proposed in the Karnataka State Excise Reforms 2026 Draft Report, moves away from the long-standing price- and product-based taxation system to a Pigouvian model that seeks to internalise the social cost of alcohol consumption, estimated at 2.0% of GSDP, amounting to approximately ₹51,000 crore annually.

Drawing on doctrinal constitutional analysis and empirical evidence, the paper argues that the proposed duty is both constitutionally sustainable and economically efficient. It is firmly grounded in the state's legislative powers under Entries 51, 8 and 54 of List II and Article 366(12A) of the Constitution and does not amount to colourable legislation seeking to disguise a fee as a tax.

The paper examines the intermediate glide-path mechanism, broader tax architecture which includes VAT and deemed input tax credit, implementation challenges, and risk mitigation measures. Karnataka's reform represents the first state-level attempt in India to align excise duty charged with the true social cost of alcohol. If implemented successfully, it can serve as a model for other states, resulting in a more coherent, evidence-based taxation system that balances harm reduction with revenue stability.

Keywords: *strength-based excise duty, Pigouvian taxation, social cost of alcohol, tax inversion, Article 366(12A), Karnataka excise reform.*

I. Introduction

On 18 April 2026, the Government of Karnataka released the *Karnataka State Excise Reforms 2026: Draft Report,* prepared by the Resource Mobilisation Committee. The report proposed to move away from the historical excise duty based on price and product to a strength-based excise duty based on "Alcohol-in-Beverage" (AIB). The Government provided a seven-day window for industrial and public stakeholders to submit objections and suggestions. Following the considerations received the Government, vide Notification No. FD 14 PES 2026 dated 8 May 2026 and in exercise of its powers under Section 71 of the Karnataka Excise Act, 1965, it notified the Karnataka Excise (Second Amendment) Rules, 2026, which came into effect on 11 May 2026. This positions Karnataka as among the first Indian state to legislatively implement a strength-based excise duty based on the Alcohol-in-Beverage (AIB) principle.

Alcohol is not a normal consumer good. Its costs extend far beyond the individual drinker to innocent third parties. The five southern states account for approximately 45 percent of national alcohol consumption, while Karnataka shows a structural paradox: only 11 percent of the population consumes alcohol, well below the national average, yet those who drink do so with high intensity.[1] The harms are well documented; over 3,000 drunk-driving deaths were recorded in 2023.[2] More than 70 percent of women whose husbands drank frequently reported experiencing domestic violence.[3] These pervasive social costs are not adequately internalised by the current excise regime, which taxes alcohol based on price and product rather than the actual content of alcohol.

This paper analyses the Karnataka Government's historic policy shift. The draft report cites several socio-economic reasons to justify this new policy. The report states that the consumption of alcohol in the state of Karnataka imposes a social cost of 2% of GSDP (central estimate), approximately ₹ 51,000 crore annually. The price and product-based excise duty system does not account for these costs, The Economy Indian Made Liquor (IML) segment, which causes the most harm, pays an estimate of ₹ 600-800 per litre of pure alcohol, instead of

[1]Resource Mobilization Comm., Gov't of Karnataka, *Karnataka State Excise Reforms 2026: Draft Report* 12 (2026) (citing MINISTRY OF HEALTH & FAMILY WELFARE, GOV'T OF INDIA, NATIONAL FAMILY HEALTH SURVEY (NFHS-5), 2019–21: KARNATAKA (2021); CRISIL RESEARCH, BOTTLED REVENUES AND UNCORKED SPIRITS (2020)).
[2]Ministry of Road Transport & Highways, Gov't of India, *Road Accidents in India – 2023* (2025), https://morth.nic.in/road-accident-in-india.
[3]RESOURCE MOBILIZATION COMM., GOV'T OF KARNATAKA, KARNATAKA STATE EXCISE REFORMS 2026: DRAFT REPORT 13 (2026) (citing S. Panda et al., *Trends and Correlates of Intimate Partner Violence Experienced by Ever-Married Women of India: Results from NFHS Rounds III and IV*, 21 BMC PUB. HEALTH 2088 (2021)).

the estimated social cost of 1,077/Litre of alcohol in beverage (LAIB) (FY 2022–23).[4] Additionally, the report claims that the current system under- taxes the products that cause the most harm and over- taxes the product that causes less harm.[5]

This paper argues that the proposed ₹ 2,000 per LAIB strength-based excise duty proposed in *Karnataka State Excise Reforms 2026 Draft Report* constitutes a constitutionally valid exercise of the state's legislative powers under Entries 51, 8 and 54 of List II and is economically efficient as a Pigouvian instrument that internalises both externalities and internalities associated with the consumption of liquor.

Table 3.1 of the report shows a structural lag in the state's alcoholic taxation levied relative to that of its social externalities. The central social cost climbed from ₹ 757 per Litre of Pure Alcohol (LPA) in FY 2018–19 to ₹ 1394 per LPA in FY 2024-25, this mirroring the state's nominal economic growth. However, the actual excise collection per Litre of Alcohol in Beverage **(**LAIB) lagged behind these central projections. This deficit shows that the earlier system's statutory tax adjustments did not maintain parity with rising social costs generated by aggregate consumption.[6] The proposed ₹ 2000 per LAIB benchmark would be more than double the current burden on the highest- harm segment, Table 10.1 confirms that the gap is not uniform, premium segments already bear excise at or above social cost, this indicates that the reform need not be across all segments but targeted.[7]

The current excise system based on price and volume suffers a fundamental problem of Tax Inversion. Table 10.1, shows that Indian Made Liquor (IML), which constitutes over 90 percent of pure alcohol consumed in Karnataka, pays only ₹ 1,123 per litre of alcohol, while beer, which constitutes a mere 9 percent of pure alcohol consumed, pays ₹ 2,381.[8] This means that the highest harm segment is systemically under- taxed constituting to a clear case of Tax Inversion. The policy aims to tax alcoholic beverages based on their social cost to society rather than the price and product system.

[4]Resource Mobilization Comm., Gov't of Karnataka, *Karnataka State Excise Reforms 2026: Draft* Report 7 (Apr. 2026).
[5]*Karnataka Draft Report*, *supra note* 1, at 11.
[6]*Id* at 24.
[7]*Id* at 24,74.
[8]*Id* at 74.

The United Kingdom's 2023 alcohol duty reform, which transitioned from a category based to a strength-based system, demonstrated that such taxation encourages substitution to lower-strength beverages and produces measurable health gains.[9]

Similarly, Australia's 2008 "alcopops tax", which imposed a 70 percent increase in excise on spirit-based Ready To Drink beverages (RTD), along with the subsequent Henry Tax Review (2010), confirmed that volumetric taxation reduces overall ethanol consumption and incentivises to move towards lower-alcohol products.[10] The World Health Organization's 2022 Global Strategy to Reduce the Harmful Use of Alcohol also identifies substitution towards lower-strength beverages as a key policy objective.[11]

To examine this reform, the paper pursues the following objectives:

- To examine the constitutional competence of the State Legislature to levy a strength-based excise duty under Entries 51, 8 and 54 of List II.
- Evaluate the Economic rationale and calibration of the ₹2,000 per LAIB social-cost benchmark set by the Government of Karnataka.
- Assess the efficiency of the intermediate glide path mechanism.
- Analyse potential legal and practical challenges and provide countermeasures for the same.

As the first Indian state to adopt a harm-based, strength-based excise system,. This sets Karnataka as a case study for other state governments to implement such excise duty reforms. The proposed reforms are also in line with the Pigouvian principles that seek to internalise the externalities caused by alcohol consumption.[12] The new reforms strive to achieve both fiscal and public goals simultaneously.

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[9]Finance (No. 2) Act 2023, c. 30, § 46 (UK); R. Burton et al., *The Early Impact of the UK's New Alcohol Taxation System on Product Strength and Price: An Exploratory Comparative Descriptive Study*, 232 Pub. Health 61 (2024), https://doi.org/10.1016/j.puhe.2024.04.005; Damon Morris et al., *Estimating the Effect of Transitioning to a Strength-Based Alcohol Tax System on Alcohol Consumption and Health Outcomes: A Modelling Study of Tax Reform in England*, 9 Lancet Pub. Health e719 (2024).

[10]Commonwealth of Australia, *Australia's Future Tax System Review [Henry Tax Review]* ch. E5-3 (2010); Steven J. Skov et al., *Is the "Alcopops" Tax Working? Probably Yes but There Is a Bigger Picture*, 195 Med. J. Austl. 84 (2011). *See also* Marianne Gale et al., *Alcopops, Taxation and Harm: A Segmented Time Series Analysis of Emergency Department Presentations*, 15 Bmc Pub. Health 468 (2015), https://pmc.ncbi.nlm.nih.gov/articles/PMC4430875/.

[11]World Health Organization, Global Alcohol Action Plan 2022–2030 (2022). See also World Health Organization, Tackling NCDs: "Best Buys" and Other Recommended Interventions (2017).

[12]*Karnataka Draft Report*, *supra note* 1, at 19.

The remainder of this paper is organised as follows: Part II develops the theoretical framework of externalities and internalities, Part III analyses the economic calibration of the ₹2,000 per LAIB benchmark, Part IV examines the constitutional sustainability of the reform, and Part V evaluates implementation mechanisms and potential challenges.

II. Theoretical Framework and Literature Review

2.1 The Economic Case for State Intervention in Alcohol Markets

Alcohol cannot be considered as a normal consumer good. Its consumption creates significant market failures in the form of negative externalities that affect not only the drinker but also to the family and society at large.[13] The two primary market failures are externalities and internalities. Externalities arise when alcohol consumption imposes costs on third parties, such as road accidents and domestic violence, that are not borne by the drinker.[14] Internalities, on the other hand, refer to the consumer's own self-control problems and addiction. A well-known field experiment in Chennai demonstrated that many individuals voluntarily chose financial incentives to remain sober, revealing a preference for commitment devices to help overcome temptation.[15]

As a result of these market failures, the private cost faced by the consumer is lower than the true social cost, leading to socially excessive consumption. The classic economic solution is Pigouvian taxation a corrective tax designed to make private actors bear the full social cost of their actions.[16] Governments achieve this by imposing corrective taxes that force private actors to internalise the externalities.[17]

Modern scholars such as Jonathan Gruber have extended this framework to "sin goods" such as alcohol and tobacco through the concept of sin taxes.[18] Gruber argues that the optimal tax

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[13]Halil Kete, *Alcohol Consumption as a Negative Externality and Public Policy Measures*, JETAS, Sept. 2022, at 12, https://www.researchgate.net/publication/366877199_Alcohol_Consumption_as_A_Negative_Externality_and_Public_Policy_Measures.
[14]*Id.*
[15]Frank Schilbach, *Alcohol and Self-Control: A Field Experiment in India*, 109 Am. Econ. Rev. 1290 (2019), https://doi.org/10.1257/aer.20170458.
[16]A.C. Pigou, *The Economics of Welfare* 111 § 13 (4th ed. 1932), https://oll-resources.s3.us-east-2.amazonaws.com/oll3/store/titles/1410/Pigou_0316_EBk_v6.0.pdf.
[17]*Id,*
[18]Jonathan Gruber, *Taxing Sin to Modify Behavior and Raise Revenue*, NIHCM Foundation (Apr. 2010), https://nihcm.org/assets/articles/expertvoices-gruber-final.pdf.

on alcohol should address both externalities and internalities and should be calibrated to alcohol content.[19]

A.C Pigou first developed the idea of corrective taxation in his book in The Economics of Welfare (1920) to address externalities. It is important to note that Pigou never mentioned the word "externality" in his book referring to them as "uncompensated disservices".[20] These ideas have been used by Jonathan Gruber to introduce concepts of sin tax and corrective taxation in his works.[21] Gruber goes on to argue that sin tax on alcohol, tobacco and obesity must also address internalities like self-control problems.[22]

These frameworks put forth by scholars like Pigou and Gruber provide an economic justification for states like Karnataka to move towards a strength-based excise system.[23] While externalities provide the traditional justification for corrective taxation, internalities offer an additional rationale for a higher tax rate. The next subsection explores internalities and self-control problems in greater detail.

2.2 Internalities and Self-Control Problems

A Swedish study found that individuals often choose "melioration," which gives immediate gratification, often making imperfect decisions and suffering from self-control problems. Internalities refer to the costs that individuals impose on their own future selves due to imperfect decision-making and self-control problems.[24] People often understand the long-term ill effects of alcohol but still struggle to limit consumption when faced with immediate temptation.[25]

Melioration is a psychological bias where people choose alternatives based entirely on immediate rewards, completely disregarding long-term consequences.[26] It explains why people

[19] *Id.*
[20] *Supra* note 16, *The Economics Of Welfare.*
[21] Jonathan Gruber, *Public Finance and Public Policy* ch. 6 (5th ed. 2016); Jonathan Gruber, *Taxing Sin to Modify Behavior and Raise Revenue*, NIHCM Found. Expert Voices, Apr. 2010, https://nihcm.org/assets/articles/expertvoices-gruber-final.pdf.
[22] *Id, Taxing Sin to Modify Behavior and Raise Revenue.*
[23] *Karnataka Draft Report*, *supra note* 1, at 16.
[24] R.J. Herrnstein et al., *Utility Maximization and Melioration: Internalities in Individual Choice*, 6 J. Behav. Decision Making 149 (1993), https://www.andrew.cmu.edu/user/gl20/GeorgeLoewenstein/Papers_files/pdf/UtilityMelioration.pdf.
[25] Marit Hinnosaar, *Time Inconsistency and Alcohol Sales Restrictions*, 87 Eur. Econ. Rev. 108 (2016), https://www.sciencedirect.com/science/article/abs/pii/S0014292116300836.
[26] R.J. Herrnstein et al., *Utility Maximization and Melioration: Internalities in Individual Choice*, 6 J. Behav. Decision Making 149 (1993), https://www.andrew.cmu.edu/user/gl20/GeorgeLoewenstein/Papers_files/pdf/UtilityMelioration.pdf.

struggle with alcohol consumption. Drinkers constantly choose instant gratification, disregarding the "internalities" of long-term health problems and hangovers they impose on their future selves, maximising short-term pleasure even when it hurts them in the long term.

A well-known field experiment conducted among cycle-rickshaw drivers in Chennai provides strong empirical evidence: when given a choice, most drivers voluntarily selected sobriety incentives over unconditional cash transfers of equal expected value, revealing a preference for commitment devices to help them resist drinking.[27] Because of internalities, the socially optimal tax rate is higher than what externalities alone would justify. A strength-based excise duty, therefore, functions as a commitment device that helps individuals better adhere to their own long-term goals. Therefore, the optimal tax equals the marginal externality plus the average marginal internality.[28]

The Draft Report's benchmark of ₹ 2,000 per LAIB is therefore justified because it accounts for both marginal externalities and marginal internalities.[29] The aim is to achieve the benchmark by FY 2028–29.[30] This approach is consistent with the intermediate glide path adopted to prevent short-term revenue volatility, price shocks, and potential diversion toward illicit consumption. Along the glide path, the system follows a hybrid approach combining a direct excise duty based on alcohol content with a simplified slab-based additional excise duty.[31]

Having examined both externalities and internalities, the next subsection reviews the empirical literature on the actual magnitude of alcohol's social costs in India and Karnataka.

2.3 Empirical Evidence on the Social Cost of Alcohol

While the theoretical justification for Pigouvian taxation is well established, the actual magnitude of alcohol's social cost must be backed by empirical evidence to determine the appropriate benchmark. In this section we will look at empirical data regarding the real social costs of alcohol. A major India-specific study by Jyani et al. (2019) estimated that alcohol-attributable deaths would cause a loss of 258 million life years between 2011 and 2050. Treatment of just three alcohol-related health conditions, i.e., cancer, liver disease, and road

[27]Frank Schilbach, *Alcohol and Self-Control: A Field Experiment in India*, 109 Am. Econ. Rev. 1290 (2019), https://doi.org/10.1257/aer.20170458.
[28]Hunt Allcott & Dmitry Taubinsky, *The Lightbulb Paradox: Using Behavioral Economics for Policy Evaluation* (working paper, 2013), https://eml.berkeley.edu/~webfac/auerbach/allcott.pdf.
[29]*Karnataka Draft Report*, *supra note* 1, at 7.
[30]*Id.*
[31]*Id* at 27.

accidents, would amount to ₹ 3,127 billion in the same period.[32] These estimates were reached using a combination of a decision tree and a mathematical Markov model to assess the health and economic costs of alcohol consumption.[33] The study further estimates average losses of 1.45% of GDP every year.[34]

An international study in 2019 covering various countries used a systematic review and meta-analysis of studies that reported costs of alcohol consumption from the year 2000; these costs were converted into 2019 international dollars. The study concluded that the economic costs of alcohol amounted to 2.6% of GDP; about a third of these costs (38.8%) were incurred directly, while two-thirds of the costs were incurred indirectly as a result of loss of productivity.[35]

The Draft Report adopts the midpoint of 2.0% of GSDP as the central estimate for Karnataka, translating into approximately ₹ 51,000 crore annually.[36] However, the current excise system based on price and volume fails to internalise these costs. The economy Indian Made Liquor (IML) segment the largest volume and highest-harm category pays an effective excise of only ₹ 600-800 per LAIB, well below the estimated social cost of ₹ 1,077 per LAIB in FY 2022–23.[37] The earlier sixteen-slab price-based classification contributed to this misalignment by systematically under-taxing high-harm products and over-taxing lower-harm ones.[38]

Table 3.1, which estimates the social cost per litre of pure alcohol, shows that it went up from ₹ 712 in FY 2018-19 to ₹ 1,270 in 2024-25, showing an approximately 78.37% increase in 6 years.[39]

Table 3.2 uses a central estimate of an additional 10% rise in social costs each year from FY 2024-25 to arrive at ₹ 2,000 per LAIB for FY 2028-29. This number acts as a policy anchor for the state to implement by 2029.[40] This empirical evidence on the magnitude of alcohol's social costs thus provides the empirical foundation for the strength-based excise duty proposed in the Karnataka reform.

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[32] G. Jyani et al., Health Impact and Economic Burden of Alcohol Consumption in India, 69 Int'l J. Drug Pol'y 34 (2019).
[33] *Id.*
[34] *Id.*
[35] Jakob Manthey et al., *What Are the Economic Costs to Society Attributable to Alcohol Use? A Systematic Review and Modelling Study*, 39 PharmacoEconomics 809 (2021).
[36] Karnataka Draft Report, *supra* note 1, at 7.
[37] *Id.*
[38] *Id.* at 10.
[39] *Id.* at 24.
[40] *Id.* at 25-26.

2.4 Price Elasticity of Demand, Behavioural Response and International Evidence on Strength-Based Taxation

After having established the magnitude of social costs, the effectiveness of any excise reform depends on how consumers react to price changes. This subsection reviews the empirical evidence on the price elasticity of demand for alcohol. A study finds that when tax on alcohol is increased by 10%, beer consumption reduces by 4.6%, wine by 6.9% and spirits by about 8%. It was also found that increased tax affects heavy drinkers but only marginally, with about a 2.8% drop in alcohol consumed among heavy drinkers.[41] A meta-analysis of 132 studies shows that an increase in the price of alcohol by 10% results in 8.3% reduction in beer consumption, 11.1% reduction in wine consumption and 10.9% reduction in spirits consumption.[42]

Indian studies show similar patterns. One study found that when price increases by 10%, consumption of country-made liquor drops by 4.6% while spirits consumption drops by only 1.4%. This inelasticity of spirits is largely attributed to low levels of education. The authors also found that elasticity varied by rural-urban divide, education and gender and therefore recommended awareness campaigns along with price controls.[43] Another study conducted in India suggests that merely raising prices is not very effective because consumption is often discretionary and habitual. The lack of substitutes also encourages households to adapt to the new prices. Hence the authors suggest a mix of price control and policies addressing social norms and cheaper substitutes.[44]

Therefore, empirical evidence points out that a shift towards a strength-based excise system that increases the relative prices of higher alcohol content products like wine and spirits encourages consumers to substitute towards lower-strength beverages like beer and lower-proof spirits. A study conducted in Illinois where in 2009 there was a sudden hike in the taxes charged on wine and spirits, while the beer taxes were raised only marginally, found that consumers substituted higher priced alcohol for beer.[45]

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[41]Alexander C. Wagenaar et al., *Effects of Beverage Alcohol Price and Tax Levels on Drinking: A Meta-Analysis of 1,003 Estimates from 112 Studies*, 104 Addiction 179 (2009), https://pubmed.ncbi.nlm.nih.gov/19149811/.

[42]Craig A. Gallet, *The Demand for Alcohol: A Meta-Analysis of Elasticities*, 51 Austl. J. Agric. & Resource Econ. 121 (2007).

[43]S. Kumar, *Price Elasticity of Alcohol Demand in India*, 52 Alcohol & Alcoholism 390 (2017), https://pubmed.ncbi.nlm.nih.gov/28430934/.

[44]V. Jadhav et al., *Price Elasticity of Demand for Alcoholic Beverages in India* (NIPFP Working Paper No. 431, 2025), https://www.nipfp.org.in/media/documents/WP-431_2025.pdf.

[45]Markus Gehrsitz et al., *The Effect of Changes in Alcohol Tax Differentials on Alcohol Consumption*, 204 J. Pub. Econ. 104520 (2021), https://pubmed.ncbi.nlm.nih.gov/35530722/.

The United Kingdom's 2023 alcohol duty reform, which transitioned from a category-based to a fully strength-based system, demonstrated that such taxation successfully encourages substitution towards lower-strength beverages and produces measurable health gains.[46] Modelling by the University of Sheffield showed that the reform would reduce overall consumption by incentivising consumers to shift away from high-strength products that were previously under-taxed relative to their alcohol content.[47] Early post-reform data further revealed that brewers quickly responded by lowering the ABV of their products in response to the new duty structure.[48]

Similarly, Australia's 2008 "alcopops tax", which imposed a 70 per cent increase in excise on spirit-based ready-to-drink (RTD) beverages, provided clear real-world confirmation of the substitution effect.[49] The tax led to a more than 30 per cent reduction in RTD sales and a 1.5 per cent decline in total pure alcohol sold nationally. Emergency department presentations for acute alcohol-related problems among young adults also decreased in the years following the reform.[50] The subsequent Henry Tax Review (2010) explicitly recommended a comprehensive volumetric tax across all beverages, concluding that a uniform rate per standard drink would create the strongest incentive for consumers and producers to move towards lower-alcohol alternatives.[51] The World Health Organization's 2022 Global Strategy to Reduce the Harmful Use of Alcohol further endorses this approach by identifying substitution towards lower-strength beverages as a key policy objective.[52]

The Draft Report also analyses various studies and holds that if the excise duty is raised to the ₹ 2,000/LAIB benchmark, then using a central estimate of price elasticity of -0.5 and income elasticity of 0.6, it projects that pure alcohol consumption shall reduce by 8-9% from approximately 0.287 billion litres in FY 2024-25 to 0.262 billion litres by FY 2030-31. Therefore, significantly reducing social costs incurred due to alcohol consumption.[53]

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[46]Finance (No. 2) Act 2023, c. 30, § 46 (UK).
[47]Damon Morris et al., *Estimating the Effect of Transitioning to a Strength-Based Alcohol Tax System on Alcohol Consumption and Health Outcomes: A Modelling Study of Tax Reform in England*, 9 Lancet Pub. Health e719 (2024).
[48]R. Burton et al., *The Early Impact of the UK's New Alcohol Taxation System on Product Strength and Price: An Exploratory Comparative Descriptive Study*, 232 Pub. Health 61 (2024).
[49]Steven J. Skov et al., *Is the "Alcopops" Tax Working? Probably Yes but There Is a Bigger Picture*, 195 Med. J. Austl. 84 (2011); *see also* Marianne Gale et al., *Alcopops, Taxation and Harm: A Segmented Time Series Analysis of Emergency Department Presentations*, 15 BMC Pub. Health 468 (2015).
[50]*Id.*
[51]Commonwealth of Australia, *Australia's Future Tax System Review [Henry Tax Review]* ch. E5-3 (2010).
[52]World Health Organization, *Global Alcohol Action Plan 2022–2030* (2022).
[53]*See* Resource Mobilization Comm., Gov't of Karnataka, *Karnataka State Excise Reforms 2026: Draft Report* 28 (April 2026) (citing Alexander C. Wagenaar et al., *Effects of Beverage Alcohol Price and Tax Levels on Drinking:*

This price responsiveness provides confidence that the strength-based excise duty will achieve its intended harm-reduction objective while maintaining revenue stability through the intermediate glide path.

Taken together, the empirical evidence on price elasticity and real-world outcomes from the United Kingdom and Australia demonstrate that a strength-based alcohol excise policy is effective in reducing harmful consumption through substitution and is practically feasible. Therefore, these international examples certainly support Karnataka's reform of moving towards a strength-based system.

III. Methodology

This paper adopts a mixed doctrinal and empirical methodology to analyse the legal sustainability and economic efficiency of Karnataka's proposed benchmark of ₹ 2,000 per LAIB, strength-based excise policy.[54] The constitutional and statutory analysis is primarily doctrinal. It examines the state's legislative powers under Article 246[55] and Entries 51, 8 and 54 of List II of the Seventh Schedule,[56] along with the implications of Article 366(12A)[57] that excludes alcoholic liquor from GST. Relevant judgements from the Supreme Court with regards to tax vs. fee distinction and the "occupied field" doctrine are also analysed.

The economic analysis relies on secondary data and empirical studies cited in the draft report,[58] social cost estimates from sources like Jyani et al. 2019 and Manthey et al. 2021[59], price elasticity studies and international reform outcomes. The analysis is a combination of positive and normative; it analyses what the reform does and also analyses whether the reforms are constitutionally valid and economically efficient.

The primary sources of this paper include Karnataka State Excise Reforms 2026 Draft Report, [60] the Karnataka Excise Act, 1965, and relevant constitutional provisions and case laws. While

A Meta-Analysis of 1,003 Estimates from 112 Studies, 104 Addiction 179 (2009); S. Kumar, *Price Elasticity of Alcohol Demand in India*, 52 Alcohol & Alcoholism 390 (2017); V. Jadhav & S. Mukherjee, *Price Elasticity of Demand for Alcoholic Beverages in India* (NIPFP Working Paper No. 431, 2025)).

[54] *Karnataka Draft Report*, *supra note* 1, at 7.
[55] Const. India art. 246.
[56] Const. India sch. VII, list II, entries 8, 51, 54.
[57] Const. India art. 366, cl. 12A.
[58] *Karnataka Draft Report*, *supra note* 1.
[59] *Supra note* Jyani et al. 2019 and Manthey et al. 2021.
[60] *Karnataka Draft Report*, *supra note* 1.

secondary sources include peer-reviewed economic literature and international policy documents.

It is pertinent to note that this paper has certain limitations which include that this paper primarily deals with publicly available data and the Draft Report; this paper does not include any primary fieldwork or new econometric modelling.

In the following sections apply this methodology is applied to examine the economic rationale and constitutional validity of the proposed reform.

IV. Economic Analysis: Social Costs and the ₹2,000/LAIB Benchmark

4.1 The Social Cost Benchmark: Methodology and Projections

The cornerstone of the Karnataka reform is the social cost benchmark of ₹ 2,000 per litre of alcohol in beverage (LAIB) by FY 2028–29.[61] This subsection explains how the Draft Report derives this figure.

The Report uses two key studies. Jyani et al. (2019)[62] focuses on the social impacts of alcohol in India. The study analyses the social cost of health impact and economic burden due to alcohol consumption. It used a combination of a decision tree and a mathematical Markov model to assess the health and economic costs of alcohol consumption. The results showed that an estimated 258 million life years would be lost between 2011 and 2050. Treatment of just three alcohol-related health conditions cancer, liver disease and road accidents would amount to ₹ 3,127 billion in the same period. The study further estimates average losses of 1.45% of GDP every year.[63]

An international study conducted by Manthey et al. (2021) used a systematic review and meta-analysis of studies that reported costs of alcohol consumption from the year 2000 onwards. These costs were converted into 2019 international dollars. The study concluded that the economic costs of alcohol amounted to 2.6% of GDP; about a third of these costs (38.8%) were incurred directly, while two-thirds of the costs were incurred indirectly as a result of loss of productivity.[64]

[61] *Karnataka Draft Report*, *supra note* 1, at 7.
[62] G. Jyani et al., *Health Impact and Economic Burden of Alcohol Consumption in India*, 69 Int'l J. Drug Pol'y 34 (2019).
[63] *Id.*
[64] Jakob Manthey et al., *What Are the Economic Costs to Society Attributable to Alcohol Use? A Systematic Review and Modelling Study*, 39 PharmacoEconomics 809 (2021).

Therefore, when the two studies are taken into consideration, the midpoint of 2% of GSDP has been taken as the central estimate in the Draft Report.[65]

The total social cost is then divided into private cost and external costs. The idea is that external costs borne by third parties should be the only consideration, as private costs are internalised by the drinkers themselves. The WHO International Guidelines tell us that 20-30% are attributed to private costs and 5% for production externalities. Therefore, a deduction of 30% is applied and results in 70% being external cost.[66]

Therefore the formula is- Social cost per LAIB = (GSDP × cost ratio × external share) / (population × per capita pure alcohol consumption)

Then the external costs are converted into per capita using official population projections for Karnataka from the Report of the Technical Group on Population Projections, 2011-2036.[67]

The Report then uses the per capita external cost and divides it with the per capita pure alcohol consumption i.e. 4.19 litres taken from WHO's data to arrive at Social cost per LAIB.[68]

Table 3.1 then shows the LAIB data from FY 2018-19 to FY 2024-25, showcasing a jump from ₹ 712 to ₹ 1,270 showing an increase of 78.37% in six years.[69]

The Report uses the central social cost estimate of 2% and using a central projection of 10% GSDP growth the LAIB would amount to ₹ 2,000 in FY 2028-29.[70] The 10 percent GSDP growth rate is a conservative figure that accounts for possibilities of high growth rates like 12 % and low growth rates of 8%.

The policy seeks to use corrective taxation by using conservative figures for projection and seek to internalise the external costs caused by alcohol consumption through corrective taxation. Having established the social cost benchmark, the next subsection examines how the current excise system based on price and volume compares with this benchmark and why it suffers from tax inversion.

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[65] *Karnataka Draft Report, supra note* 1, at 15.
[66] World Health Organization, *International Guidelines for Estimating the Costs of Substance Abuse* (2002), https://apps.who.int/iris/handle/10665/42744;*Karnataka Draft Report, supra* note 1, at 23.
[67] *Karnataka Draft Report*, *supra note* 1, at 24.
[68] *Id.*
[69] *Id.*
[70] *Id* at 25.

4.2 Current Excise System based on price and volume vs Social Cost Benchmark – Tax Inversion

While the Karnataka Government's social cost benchmark provides an ideal corrective tax rate to help internalise some of the externalities, the current excise policy based on price and volume is not aligned with the benchmark, hence failing to internalise the external costs borne by third parties.

The core problem of the current excise system is that it is based on price and volume instead of the pure alcohol content, that is the cause of the actual harm. This system creates a fundamental misalignment as it constantly under-taxes the products causing the most harm and over-taxes products that cause less harm.[71] The Draft Report cites data from NFHS-5 2021 to show the paradox of alcohol consumption in Karnataka. The population of people who consume alcohol above 15 years of age is 8.62% lower than the national average of 10%. However, the per capita consumption of alcohol is approximately 9.1 litres per year compared to the 6.4 litres national average.[72] This means that in Karnataka though the number of drinkers is relatively low, those who consume alcohol consume it in large quantities. A study conducted in Minnesota held that when there is excessive drinking, the societal costs increase with increase in crime, lower productivity and higher healthcare costs.[73]

The system based on price and volume creates a fundamental problem of tax inversion a system where the more harmful products are under-taxed and the less harmful products are over-taxed. A paper based on data from the United States of America finds that if the Government increases taxes on a safer substitute i.e. e-cigarette, then the citizens are most likely going to increase consumption of the more harmful traditional tobacco-based cigarette.[74] Therefore, the current inverted duty structure that under-taxes the more harmful products encourage individuals to consume higher strength-based products. This might be one of the reasons that the per capita per litre consumption of alcohol in Karnataka is higher than the national average.

The data from the Draft Report shows exactly this. The Economy IML segment which is high in alcohol content has an excise duty of ₹ 600–800 per litre of pure alcohol, while premium

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[71]*Karnataka Draft Report*, *supra note* 1, at 10,20.
[72]*Id* 47
[73]Jeffrey J. Sacks et al., *Assessing the Costs of Excessive Alcohol Consumption in the U.S.*, 63 Am. J. Preventive Med. 512 (2022).
[74]Michael F. Pesko, Charles J. Courtemanche & J. Catherine Maclean, *The Effects of Traditional Cigarette and E-Cigarette Tax Rates on Adult Tobacco Product Use*, 60 J. Risk & Uncertainty 229 (2020).

and imported products are charged with duty much above the social cost benchmark.[75] This current system therefore promotes individuals to consume cheaper, higher alcohol content products, thereby increasing the social cost. The under-taxation also leads to losses of revenue for the state while the social cost of consumption of these products is often borne by the state.

The new system seeks to correct this inversion by taxing products based on actual alcohol content. The new policy effective May 11 vide Notification No. FD 14 PES 2026 dated 8 May 2026 has reformed the earlier 16 price-based slabs to an 8-slab structure for Indian Made Foreign Liquor (IMFL) that has a uniform excise duty structure based on alcohol content and an additional excise duty based on ex-factory price slab. There is also a 3-slab structure for beer where excise duty is charged on actual alcohol content and an additional excise duty is charged based on ex-factory price.[76]

Having identified the structural flaws in the current system, the next sub-section analyses how the proposed intermediate glide-path seeks to address these issues while ensuring revenue stability during the transition period.

4.3 The Proposed Strength-Based Excise and Glide-Path Mechanism

The reform does not seek to immediately implement the ideal ₹ 2,000 per LAIB strength-based duty. It instead proposes a pragmatic intermediate hybrid system as a glide path to ensure that the transition is smooth and there is revenue stability for the Government.[77]

The new framework combines a uniform excise duty directly linked to alcohol content with a simplified slab-based additional excise duty based on ex-factory price. This has been done to ensure there is a uniform excise duty linked to alcohol content that causes the most harm. The strategic reduction of additional excise duty slabs from 16 to 8 has been implemented because the earlier slab system hyper-segmented various price brackets. Manufacturers would often adjust prices to avoid additional tax liability without making any changes to the product or alcohol content. Therefore, the wider slabs ensure that such price adjustments by manufacturers to avoid tax liability are no longer feasible. This ensures that manufacturers move towards a pricing strategy based on market factors like consumer demand. This makes the pricing of cheap and premium alcohol more transparent.[78]

[75] *Karnataka Draft Report*, *supra note* 1, at 7,10,25.
[76] *Karnataka Draft Report*, *supra note* 1, at 75-76.
[77] *Karnataka Draft Report*, *supra note* 1, at 7-8.
[78] *Id*, at 75.

These reforms help in the correction of the inversion in duty charged, where higher-alcohol content products are under-taxed while lower-alcohol content products are over-taxed. This can be seen in the previous section where the economy Indian Made Liquor segment with higher alcohol content is under-taxed, while premium products though higher in price contained lesser alcohol were over-taxed. A combination of uniform excise duty based on alcohol content and additional excise duty based on 8 slabs of ex-factory cost helps ensure that this inversion is fixed.[79]

The report proposes a target of ₹ 1,542 per LAIB by FY 2026-27. This target has been set based on estimates of the lower-bound social cost i.e. 1.45% of GSDP considering a GSDP estimate of ₹ 43,500 crore. This means that there shall be an increase of 25% over the current average excise levels.[80] This glide path shall help ensure that while the revenue of the Government shall be stable, there will be a considerable decline in the consumption of pure alcohol, while ensuring that the ₹ 2,000 per LAIB target is reached by FY 2028-29.

This highlights that the transition timeline has already been set off with the announcement of the budget for FY 2026-2027 which for the first time introduced Alcohol-in-Beverage-based excise duty structure from April 2026 and the rationalization of pricing slabs from sixteen to eight, highlighting the Government's commitment of reaching the ₹ 2,000 per LAIB benchmark by FY 2028-29.

The policy adopts these intermediate guidelines to ensure that while the overall social cost and externalities are internalised there is no disruption of stable revenue earned by the government and prevents problems like sudden price hike and consumption through illicit channels.[81]

Having examined the proposed intermediate glide path, the next subsection analyses the broader tax architecture, including the role of VAT and deemed input tax credit in the new system.

4.4 The Broader Tax Architecture

The strength-based taxation system is just one part of the broader tax architecture envisioned by the state. The Draft Report proposes a dual-tax structure that consists of the Pigouvian

[79]*Id,* at 74-76.
[80]*Id,* at 27.
[81]*Id.*

corrective taxation of charging alcohol per LAIB and a general consumption tax called VAT at the state level.[82]

The specific corrective excise duty charged per LAIB seeks to perform the Pigouvian function of internalising the externalities and internalities of harms caused to society as a result of alcohol consumption.[83] This duty is the main instrument to bring down the overall social costs of alcohol consumption.

The strength-based excise duty forms the core of this corrective/Pigouvian taxation system. VAT, levied at 18% on the excise-inclusive transaction value, serves as a general consumption tax that brings alcohol broadly in line with other goods for revenue other goods for revenue purposes.

Following the GST 2.0 reforms effective 2025–26, most sin goods such as tobacco and pan masala now attract a consolidated 40% GST rate (replacing the earlier 28% GST + compensation cess structure). Alcohol, however, continues to remain outside the GST framework under Article 366(12A). Karnataka has therefore wisely avoided layering any additional "sin tax" cess on top of the strength-based excise. This prevents double-counting of social harm and excessive price distortion, as the corrective function has already been performed by the strength-based excise duty.[84]

Let us understand this with the help of an example.

Illustrative Comparison (Post-GST 2.0)

Tobacco (a typical sin good under GST 2.0):

- Base value: ₹100
- GST @ 40%: ₹40
- Total tax component: ₹40 (plus any specific central excise/NCCD where applicable)

Alcohol under Karnataka's New Model:

- Base wholesale value (pre-excise): ₹100
- Strength-based Excise (Pigouvian, illustrative ₹30 for this example): ₹30

[82]*Karnataka Draft Report*, *supra note* 1, at 32-33.
[83]*Id,* at 32.
[84]*Id.*

- VAT @ 18% on excise-inclusive value (₹130): ₹23.40
- Efficient Total Tax: ≈ ₹53.40

In the case of Double-counting the harm If the Government decides to treat alcohol as a GST sin good and add an additional cess (say 12–15%) on top of the corrective excise:

- Excise: ₹30
- VAT @ 18%: ₹23.40
- Additional sin cess: ₹12–15
- Inefficient Total: ₹65+

In the above case we can see how the additional cess tax when applied on an already corrective taxation system will increase the price of alcohol drastically and may lead to price volatility, affect government revenue and promote illicit consumption.

The Draft Report also seeks to mitigate the effect of cascading taxation. Since alcohol is exempted from GST, the problem of conflict between the two systems occurs during manufacturing. Manufacturers pay GST during the production of alcohol for the raw materials, transport, glass-packaging etc, however the manufacturers cannot claim Input Tax Credit for the taxes paid at the manufacturing stage.[85]

The Government seeks to correct this anomaly by proposing a flat deduction of Input Tax Credit against VAT liability for domestic distribution and production. The rate of this deduction shall be determined after a thorough study of GST burden during alcohol production. The report uses an illustrative figure of 6% till such study is completed, making the effective VAT liability (when VAT rate is 18%) 12%.[86]

Let us assume a manufacturer incurs ₹ 100 in raw materials and packaging costs for alcohol production and sells the bottle for a wholesale price of ₹ 200. Assuming GST for raw materials is 18% and VAT on the final product is also 18%.

The Current Anomaly (Cascading Tax / No ITC)

[85]*Id,* at 33.
[86]*Id.*

Without the Draft Report's proposals, the manufacturer gets hit by trapped taxes:

1. Tax on Inputs: The manufacturer pays ₹ 18 GST (18% of ₹ 100) on glass, transport, and ingredients.
2. Tax on Output: The state levies an 18% VAT on the ₹ 200 final product = ₹ 36.
3. The Problem: Because alcohol is outside GST, the manufacturer cannot use the ₹ 18 input tax to reduce the ₹ 36 output tax.
4. Total Tax Burden: ₹ 18 (GST) + ₹ 36 (VAT) = ₹ 54.

The ₹ 18 input tax gets "trapped" as a cost, forcing the manufacturer to hike prices.

The Draft Report's Solution (Flat 6% Deduction)

To fix this without a complex tracking system, the government allows a flat 6% "illustrative" deduction directly from the 18% final VAT rate, reducing the effective VAT rate to 12%.

1. Tax on Inputs: The manufacturer still pays ₹ 18 GST on inputs.
2. Corrected Tax on Output: Instead of 18%, the state applies the effective 12% VAT rate on the ₹ 200 final product = ₹ 24.
3. Total Tax Burden: ₹ 18 (GST) + ₹ 24 (Effective VAT) = ₹ 42.

The total tax drops from ₹ 54 to ₹ 42, effectively neutralizing part of the trapped input tax.

However, this system shall not be applicable to imported liquor. Imports shall incur the entire burden of VAT without any Input Tax Credit. This is done to prevent imported liquor from receiving an undue tax advantage.[87]

The Draft Report also states that the proposed reforms shall be applicable only to alcohol for human consumption. They shall not be applicable to industrial alcohol which is used in the manufacturing and pharmaceutical sectors. Since there are no external social costs involved in industrial alcohol, there is no need to regulate it with corrective taxation.[88]

The broader taxation system is set with the objectives of ensuring regulation of consumer consumption and ensuring stable revenue for the government. With the broader tax architecture

[87] *Id,* at 34.
[88] *Id.*

in place, the reform also requires significant modernisation of the regulatory and administrative framework, which shall be examined in the next section.

V. Constitutional Analysis

5.1 Constitutional Basis: State Powers under the Seventh Schedule

The constitutional validity of Karnataka's proposed strength-based excise duty rests primarily on Article 246 which distributes legislative powers between the Centre and the States, read with the Seventh Schedule of the Constitution.

Article 246[89] of the Constitution, specifically clause 3, gives "exclusive power" to the State Legislature to make laws for their State with respect to all matters present in List II of Schedule VII.

There are several entries under Schedule VII List II of the Constitution that become relevant in this context.[90] Entry 8 gives exclusive powers to the State to regulate the production, manufacturing, transport, purchase and sale of intoxicating liquor. Entry 51 grants States exclusive rights to charge duties of excise on the manufacture and production of alcohol for human consumption in the State. Entry 54 allows States to charge sales taxes on alcohol for human consumption; the proposed VAT reform shall fall under Entry 54 as alcohol is excluded from GST under Article 366.

Article 366, specifically clause 12A, which defines Goods and Services Tax (GST), explicitly exempts taxes on the supply of alcohol for human consumption.[91] This implies that all duties and sales taxes levied on the consumption of alcohol are entirely within the discretion of the State Government, which can regulate and make laws on the same. This power of the State helps to ensure that social cost harms are minimised and accounted for through taxation and imposition of duty and also serves as a stable revenue source for the State.

The Supreme Court has consistently and historically held that States have near-plenary powers over both the regulation and taxation of alcoholic liquors for human consumption. The Court has taken a broad and liberal interpretation of the entries under List II that give the State powers

[89]Const. India art. 246.
[90]Const. India sch. VII, list II.
[91]Const. India art. 366, cl. 12A.

to regulate and tax alcohol consumption. In *State of Bombay v. F.N. Balsara* (1951),[92] the Supreme Court held that the State has extensive regulatory and taxing power over intoxicating liquors under Entry 51. This serves as an early landmark case by the Supreme Court that upheld the Bombay State's competence to make laws under Entry 51 for liquor consumption even if broadly defined. The Supreme Court in *Bihar Distillery v. Union of India* (1997)[93] gave a broad interpretation of Entry 51 under List II to hold that States can levy excise on all forms of alcohol fit for human consumption. Recently, in a nine-judge bench judgment in *State of U.P. v. Lalta Prasad Vaish* (2024),[94] the Supreme Court held that States have wide legislative competence over "intoxicating liquors" under Entry 8 of List II, including industrial alcohol, overruling the earlier narrow view held in the seven-judge bench in *Synthetics and Chemicals v. State of U.P.* (1990).[95] These cases affirm the Supreme Court's broad and liberal interpretation of entries under List II that are related to the regulation and taxation of alcohol for consumption.

Therefore, the strength-based excise duty reform falls under Entry 51 of List II, which confers exclusive power on the States to levy excise duty on alcoholic liquors for human consumption. This entry has been interpreted liberally by the Supreme Court to allow the State considerable flexibility in designing the structure, rate and base of excise duty to achieve both revenue and regulatory objectives set forth by the State. The shift from the current product and price-based system to the new strength-based duty levied per litre of alcohol in beverage (LAIB) is constitutionally legitimate and falls within the rights of the State.

Further, the accompanying regulatory framework like digital track-and-trace systems, licensing requirements and registration-based market entry[96] is supported by Entry 8 of List II, which empowers the State to regulate the production, manufacture, possession, transport, purchase and sale of intoxicating liquors. Therefore, read together, Entries 51 and 8 of List II provide a comprehensive constitutional basis for both the regulatory and taxation aspects of the proposed reform.

92 *State of Bombay v. F.N. Balsara*, (1951) SCC 860, ¶ 59.
93 *Bihar Distillery v. Union of India*, (1997) 2 SCC 727, ¶ 10.
94 *State of U.P. v. Lalta Prasad Vaish*, (2024) 17 SCC 1, ¶ 156.7-156.9.
95 *Id,* at ¶ 156.9.
96 *Karnataka Draft Report, supra* note 1, at 9.

5.2 Tax vs Fee Distinction and Colourable Legislation

Having established the constitutional competence of the State to levy a strength-based excise duty, the next subsection seeks to examine the distinction between tax and fee and whether the proposed levy could be challenged as a colourable exercise of legislative power.

This distinction between tax and fee was most clearly laid down in the landmark case of *Commissioner, Hindu Religious Endowments v. Sri Lakshmindra Tirtha Swamiar* (Shirur Mutt, 1954).[97] The Supreme Court held that a tax is a compulsory exaction of money by public authority for public purposes, enforceable by law, and is not a payment for services rendered.[98] In contrast, a fee is a charge levied for a specific service rendered by the government to the individual.[99] The Court further clarified that the mere element of compulsion cannot be the sole distinguishing factor between a tax and a fee; the essential difference lies in the fact that a tax is levied for a common public burden, whereas a fee is levied for services rendered to the payer.[100]

Applying this test to the proposed reform, the ₹ 2,000 per LAIB strength-based excise duty is clearly a tax and not a fee. It is imposed for the general public purpose of internalising the massive social costs (externalities and internalities) associated with alcohol consumption and is not linked to any specific service provided to the manufacturer or seller. The primary objective of this levy is to correct market failures and generate stable revenue for the State while regulating alcohol consumption.

One possible challenge could be that the levy is in substance a fee or a regulatory charge disguised as a tax, amounting to colourable legislation. However, the Draft Report and constitutional jurisprudence make it abundantly clear that this is a genuine Pigouvian tax whose objective is to mitigate and internalise the social costs of alcohol consumption while also serving as a stable revenue source for the Government.[101]

The Supreme Court has consistently held that a levy can be valid even if it has a regulatory element, as long as the primary object is revenue or public purpose. The proposed strength-based excise duty is squarely within Entry 51 of List II. The Karnataka Government's levy

[97] *Commr., Hindu Religious Endowments v. Lakshmindra Thirtha Swamiar of Sri Shirur Mutt*, (1954) 1 SCC 412, ¶ 44,45.
[98] *Id,* at ¶ 44.
[99] *Id,* at ¶ 45.
[100] *Id,* at ¶ 46.
[101] *Karnataka Draft Report*, *supra* note 1, at 38.

satisfies the test laid down in the *Shirur Mutt*[102] case as it is imposed for the general public purpose of correcting the externalities and internalities of alcohol consumption. The decisions in *Bihar Distillery v. Union of India* (1997)[103] and the recent nine-judge bench decision in *State of U.P. v. Lalta Prasad Vaish* (2024)[104] have consistently affirmed that State Governments in India have wide and discretionary powers with respect to regulating and taxing the consumption of alcohol. Therefore, the proposed duty cannot be struck down as colourable legislation.

The proposed excise tax on basis of strength falls well within the purview of the constitutional scheme that regulates the relationship between the excise tax and the GST regime. Section 366(12A) of the Constitution exempts alcoholic liquor meant for human consumption from the scope of goods and services. This exemption was intended to safeguard the exclusive legislative powers of the states under Entry 51 of the List II. Thus, imposing an excise tax per litre on LAIB qualifies as an exercise of the State's legislative power under List II. Consequently, the dual system of corrective excise taxation and state VAT is constitutional.

VI. Implementation, Efficiency and Risk Mitigation

The successful implementation of the proposed reforms requires a major overhaul and modernisation of the regulatory and administrative framework. The Draft Report acknowledges this requirement and recommends moving from the current ex-ante physical control and inspection systems to a more technology-based, risk-based method of ensuring compliance.[105]

The Report also proposes a mandatory digital track-and-trace system (based on QR codes or e-locks) for real-time monitoring of production, movement, and sale of liquor. The objective is to prevent evasion, strengthen enforcement, and improve the ease of doing business for legitimate players.[106] This recommendation draws inspiration from successful models already implemented in other states. For instance, West Bengal's e-Abkari system and Punjab's e-Abkari project have demonstrated the effectiveness of digital tracking in liquor supply chain management.[107] Andhra Pradesh has also adopted a similar track-and-trace model with

[102] *Commr., Hindu Religious Endowments v. Lakshmindra Thirtha Swamiar of Sri Shirur Mutt*, (1954) 1 SCC 412.
[103] *Bihar Distillery v. Union of India*, (1997) 2 SCC 727.
[104] *State of U.P. v. Lalta Prasad Vaish*, (2024) 17 SCC 1.
[105] *Karnataka Draft Report*, *supra* note 1, at 85.
[106] *Id,* at 86.
[107] *Excise Directorate*, Gov't of West Bengal, https://excise.wb.gov.in/Portal_New_Default.aspx.

encouraging results.[108] These systems use modern technologies such as geo-tagging, QR codes, mobile apps, and real-time reporting, which have not only improved compliance but also significantly reduced leakages.

The success of these digital initiatives is evident from the recognition they have received. West Bengal's Excise Directorate has been awarded the Digital India Award by the Hon'ble President of India and the National e-Governance Award by DARPG, Government of India.[109] Similarly, the NIC Punjab and State Excise Department, Punjab, received the Technology Sabha Excellence Award 2023 for their e-Abkari system.[110]

The current quota-based licensing and KSBCL's monopoly as sole wholesaler create inefficiencies, rent-seeking opportunities, and high compliance costs for legitimate businesses. The Draft Report recommends a phased transition from quota-based licensing to registration-based market entry with spatial regulation of retail outlets.[111] This reform aims to reduce administrative burdens and promote greater competition in the distribution chain.

The role of KSBCL as sole wholesaler should be reviewed; competitive wholesale under digital oversight is suggested to improve efficiency and transparency. Fixed percentage retail margins also need reform to reduce distortions and improve overall efficiency in the supply chain.[112]

Higher taxes on alcohol cheap high-strength alcohol, may carry risk of promoting the consumption of alcohol through illicit channels. The Draft Report seeks to address this by designed phased glide path, mandatory digital track-and-trace infrastructure, stronger border enforcement, and public awareness campaigns. The Intermediate hybrid system of a unfirm excise duty on alcohol content plus an additional excise duty based on price slabs help avoid sudden price shocks and revenue volatility.[113] Additional measures like risk-based enforcement and continuous monitoring prevent the adulteration of alcohol.

Successful implementation of the proposed implementation requires s strong political-will and inter-departmental coordination between the police, excise and finance department along with adoption of technology and compliance monitoring. This phased transition path and technology

[108] *White Paper on Excise Duties/Revenue*, Gov't of Andhra Pradesh (July 2024), https://media-abn.s3.ap-south-1.amazonaws.com/media/2024/20240707/V15_HCM_22_07_2024_White_Paper_Excise_6fa29c3e75.pdf.
[109] *Excise Directorate*, Gov't of West Bengal, https://excise.wb.gov.in/Portal_New_Default.aspx.
[110] Parminder Kaur, *NIC, Punjab and State Excise Punjab (eAbkari-Punjab) Bags Coveted Technology Sabha Excellence Award 2023 at Technology Sabha Conference 2023 in Kochi (Kerala)*, Informatics News (Mar. 9, 2023), https://informatics.nic.in/news/1456.
[111] *Karnataka Draft Report, supra* note 1, at 84.
[112] *Id,* at 11.
[113] *Id,* at 70-79.

enabled transition shall pave a balanced path to achieve harm reduction while protecting revenue.

VII. Challenges, Counter-Arguments and Policy Recommendations

There may be considerable opposition and criticism to the proposed reforms, particularly from those who benefited under the old system. Raising taxes on cheap, high-strength alcohol is likely to face resistance from companies operating in the economy IML segment. The Draft Report itself recognises these potential challenges, including the risk that consumers previously buying economy IML may shift to illicit channels. This could lead to increased cross-border smuggling and hooch tragedies caused by spurious liquor contaminated with methanol.[114] Hooch tragedies are not uncommon in India when states attempt stricter regulation of alcohol. For example, a study of the 2009 methanol poisoning incident in Ahmedabad, Gujarat, showed how illicit alcohol adulterated with methanol led to severe health consequences.[115] Similarly, Bihar's alcohol prohibition policy has been associated with bootlegging, mafia involvement, corruption, and deaths from spurious liquor.[116]

These concerns have been addressed in the Draft Report.[117] It proposes a phased implementation of an intermediate hybrid system uniform excise duty based on alcohol content plus a simplified slab-based additional excise duty along with mandatory digital track-and-trace systems. These measures are designed to minimise the risk of illicit trade while gradually aligning taxation with social costs. The reforms ultimately seek to reduce the harm inflicted on society while maintaining stable revenue through indexation and substitution effects. The shift to registration-based market entry will also make it easier for legitimate businesses to operate.

Moving forward, this paper recommends that the Government strictly adhere to the intermediate glide-path plan and ensure full implementation of the digital track-and-trace system before any major rate increase. Public awareness campaigns highlighting the social costs of alcohol consumption should be launched to build public trust and support. The promised empirical study on the appropriate rate of deemed input tax credit should be completed at the earliest to finalise the VAT component of the new architecture. Finally,

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[114] *Karnataka Draft Report, supra* note 1, at 70.
[115] B.S. Jarwani, P.D. Motiani & S. Sachdev, *Study of Various Clinical and Laboratory Parameters Among 178 Patients Affected by Hooch Tragedy in Ahmedabad, Gujarat (India): A Single Center Experience*, 6 J. Emergency Trauma Shock 73 (2013).
[116] Manu Sakshi, *Examining the Unintended Consequences of Bihar's Alcohol Ban*, ATSK J. Sociology (2025), https://atsk.website/wp-content/uploads/2025/04/Manu-Sakshi.pdf.
[117] *Karnataka Draft Report, supra* note 1, at 71.

complementary non-tax measures such as stricter enforcement of drunk-driving laws, expansion of rehabilitation centres for excessive alcohol users, and community-level interventions should be adopted to address the demand side of the problem.

If implemented alongside the proposed excise reforms, these recommendations will help the Government maintain a steady revenue source while significantly reducing the harm caused by alcohol consumption in the state.

VIII. Conclusion

This paper would like to once again reiterate in its conclusion that the state of Karnataka's proposed ₹2,000 per LAIB strength-based excise duty is both constitutionally sustainable and economically efficient because it directly internalises the massive social costs of alcohol consumption through a Pigouvian approach.

This reform helps in the correction of the long-standing problem of tax inversion in the system based on price and product. This policy will reward those manufacturers that have less alcoholic content in their beverages or products. The policy also promotes manufacturers to cut down alcoholic content or introduce new products with less alcohol. It seeks to shift from a revenue-maximising model to a more harm-reduction model that also ensures that the state earns revenue through the intermediate-glide path and indexation. It also serves as a pioneer to other states to implement such models that are made with the objectives of achieving social welfare and reduction of social cost rather than administrative convenience and revenue-greedy policies.

These policies are also legally sustainable, as the reforms are strictly grounded in Entries 51, 8 and 54 of List II, Article 366(12A) of the constitution. The Supreme Court cases also give an additional layer of validity to these reforms, and these reforms cannot be held as colourable legislation that disguises collecting fees in the form of tax. This has been discussed in length in part V.

This policy is also expected to reduce consumption by 8-9% in terms of pure alcohol consumption; this can be attributed to the substitution effect towards lower-strength beverages. This will lead to lower social costs incurred in the state and a reduction in road accidents, a reduction in domestic violence cases and a reduced burden on health care in the state. These expected outcomes shall help the state progress and improve the standard of living and productivity among its citizens.

Karnataka has the opportunity to become the first state in India to align excise policy with the true social cost of alcohol. This implementation, if successful, could serve as a template for other states to follow and may result in the reduction of overall social cost related to alcohol nationally and may improve the country's overall health, productivity and standard of living.

Emphasis must be placed on the need to strictly implement the glide path, full digital track-and-trace rollout, complementary non-tax measures (enforcement, treatment, and awareness), and continuous monitoring as the reforms envision. The plan seems to have great evidence and be economically efficient and legally valid; however, the success shall depend solely on the implementation. Implementation shall require interdepartmental coordination and administrative backing and government's guidance.

In conclusion Karnataka's efforts must gain respect and admiration for leading the way with such bold and promising excise reforms. Karnataka's model of excise duty may be the start of excise policies that are socially responsible and seek to minimise social harms while gaining a stable revenue. All of this now depends on the successful implementation of the proposed reforms.

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