

CASE NO.:
Appeal (civil) 4172-4185 of 2000

PETITIONER:
Commnr. of Central Excise, Indore

RESPONDENT:
M/s S. Kumars Ltd. & Ors.

DATE OF JUDGMENT: 21/11/2005

BENCH:
Ruma Pal & H.K. Sema

JUDGMENT:
J U D G M E N T

With
C.A. Nos. 775-781 of 2004

RUMA PAL, J.

The respondent No. 1 processes grey fabric. Sometimes the grey fabrics are processed on its own account and sometimes the grey fabrics are received for processing on job charge basis from others (who are referred to as 'the merchant manufacturers'). For the period 01.09.1985 to 28.02.1989, the respondent No. 1 had paid excise duty on the fabrics processed by it during this period, calculating the duty payable by treating the value of the processed fabrics as being that at which the merchant manufacturer was selling the processed goods. According to the respondents, this was in keeping with the decision of this Court in *Empire Industries Ltd. V. Union of India & Ors.* (1985) 3 SCC 314 (briefly referred to as *Empire Industries*). With effect from 01.03.1989, the same method was followed in respect of the fabrics processed by the respondent No. 1 on its own account. However, on the fabrics processed by it which had been received from the merchant manufacturers, the respondent No. 1 valued the processed goods on the basis of the cost of grey fabrics plus the processing charges as well as its manufacturing expenses and profits. In other words, the price at which the merchant manufacturer was selling the processed goods was not taken. This was done relying upon the decision of this Court in *M/s Ujagar Prints and Others V. Union of India* (1989) 3 SCC 488 (briefly referred to as *M/s. Ujagar Prints II*) as explained in *M/s Ujagar Prints and Others V. Union of India and Others* (1989) 3 SCC 531 (briefly referred to as *M/s. Ujagar Prints III*). On 5th October 1990, a show cause notice was issued by the appellant to the respondent proposing to recover differential duty of excise amounting to Rs.4,84,62,452/- from the respondent No. 1 within the extended time limit under the proviso of Section 11A of the Central Excise Act, 1944 (hereinafter referred to as 'the Act') and proposing to impose penalty against the respondents. The basis of the demand against the respondents was that they were all firms and companies having a common management and control with some of them selling grey fabric to the respondent No.1 which, after processing the fabrics, sold the same to some of the other respondents. The latter ultimately sold the processed fabrics to

independent dealers. All the respondents were described as 'S.Kumars' and the appellants claimed to treat the price charged by the trader respondents from the independent dealers as the assessable value of the processed fabrics and to levy excise duty thereon. The respondents replied to the show cause notice. They denied that the respondents were related persons and disputed the basis for the additional claim of excise duty. It was submitted that by virtue of this Court's decision in M/s. Ujagar Prints III they were liable to treat the notional sale by the respondent No.1 to the merchant manufacturers as the relevant point for determining the assessable value. The claim of the respondent No.1 was that prior to the decision in M/s. Ujagar Prints III it had paid the excise duty by taking the assessable value of the processed fabric at the wholesale price at the time the goods reached the open market. This was followed till the decision of this Court in Ujagar Prints III. It was submitted that in any event the respondent No.1 was not only entitled to discounts in respect of the excise duty levied for the period 01.09.1985 to 28.02.1989 but there were gross inaccuracies in the computations made by the appellant. The Commissioner of Central Excise, held that the respondents were related persons and upheld the demand for duty to the extent of Rs.3,82,41,53 for the period 01.09.1985 to 30.09.1989 from the respondent No. 1. The claim for discounts was also rejected.

The respondents appealed before the Customs, Excise and Gold (Control) Appellate Tribunal (hereinafter referred to as the 'Tribunal'). The Tribunal held that the respondents had rightly invoked the principles of M/s Ujagar Prints III. In doing so, it did not go into the question whether the respondents were related persons as alleged in the show cause notice. The Tribunal therefore allowed the respondents' appeal and remanded the matter back to the Commissioner in order to re-compute the duty payable.

Being aggrieved, the appellant has preferred these appeals. By this judgment, we propose to dispose of these appeals as well as other appeals preferred by the appellant from orders of the Tribunal in which the Tribunal has merely followed the decision in the case of the respondents.

The demand for excise duty raised by the appellant against the respondent's covers the period 1985 to 1989. The period in question may conveniently be considered in two parts, namely, (1) 01.09.1985 to 28.02.89 and (2) 01.03.1989 to 30.09.1989. The reason for the division of the period in two parts is the law which this Court has laid down in M/s Ujagar Prints III. The first question, therefore, is what did this Court decide in that decision? Having determined that, the next question would be whether the principles so laid down apply to the respondents' case.

But before we determine these questions we would have to consider the law in the background of which the decision in M/s. Ujagar Prints III was rendered.

The principles of valuation for the purposes of charging excise duty are contained in Section 4 of the Act. Section 4 in so far as it is relevant, provides:-
"(1) Where under this Act, the duty of excise is chargeable on any excisable goods with reference to value, such value shall, subject to the other provisions of this section, be deemed to be\027

(a) the normal price thereof, that is to say, the price at which such goods are ordinarily sold by the assessee to a buyer in the course of wholesale trade for delivery at the time and

place of removal, where the buyer is not a related person and the price is the sole consideration for the sale:

Provided that---

(iii) where the assessee so arranges that the goods are generally not sold by him in the course of wholesale trade except to or through a related person, the normal price of the goods sold by the assessee to or through such related person shall be deemed to be the price at which they are ordinarily sold by the related person in the course of wholesale trade at the time of removal, to dealers (not being related persons) or where such goods are not sold to such dealers, to dealers (being related persons) who sell such goods in retail;

(b) where the normal price of such goods is not ascertainable for the reason that such goods are not sold or for any other reason, the nearest ascertainable equivalent thereof determined in such manner as may be prescribed.

(2) xxx xxx xxx xxx xxx

(3) xxx xxx xxx xxx xxx

(4) (a) xxx xxx xxx xxx xxx

(b) xxx xxx xxx xxx xxx

"(c) related person" means a person who is so associated with the assessee that they have interest, directly or indirectly, in the business of each other and includes a holding company, a subsidiary company, and relative and a distributor of the assessee and any sub-distributor of such distributor".

Section 4(1)(a) deals with cases where the assessee sells the manufactured goods to a buyer, whereas Section 4(1)(b) deals with cases other than sale. Chapter II of the Central Excise (Valuation) Rules, 1975 (referred to hereafter the Rules), provides for the determination of the value of any excisable goods for the purposes of Section 4 (1)(b) of the Act. We may note at the outset that Rule 3 provides for the applicability of all the valuation rules when it says 'the value of any excisable goods shall, for the purposes of clause (b) of sub-section (1) of Section 4 of the Act, be determined by the proper officer in accordance with these rules'. No distinction is made between the applicability of the succeeding rules save that they are to be considered for application in numerical order. Rule 4 deals with the determination of the value of excisable goods on the basis of sale by the assessee at any other time nearest to the time of the removal of the goods being assessed. Rule 5 deals with a situation when the excisable goods are sold in circumstances specified in Section 4(1)(a) of the Act. If the price is not the sole consideration, the value of the excisable goods is required to be based on the aggregate of the price and "the amount of the money value of any additional consideration flowing directly or indirectly from the buyer to the assessee". If the value of the excisable goods

cannot be determined under Rules 4 or 5 then the procedure prescribed under Rule 6 would have to be followed viz.

"(a) where such goods are sold by the assessee in retail, the value shall be based on the retail price of such goods reduced by such amount as is necessary and reasonable in the opinion of the proper officer to arrive at the price at which the assessee would have sold such goods in the course of wholesale trade to a person other than a related person;

Provided that in determining the amount of reduction, due regard shall be had to the nature of excisable goods, the trade practice in that commodity and other relevant factors.

(b) where the excisable goods are not sold by the assessee but are used or consumed by him or on his behalf in the production or manufacture of other articles, the value shall be based--

(i) on the value of the comparable goods produced or manufactured by the assessee or by any other assessee:

Provided that in determining the value under this sub-clause, the proper officer shall make such adjustments as appear to him reasonable, taking into consideration all relevant factors and, in particular, the difference, if any, in the material characteristics of the goods to be assessed and of the comparable goods;

(ii) if the value cannot be determined under sub-clause (i), on the cost of production or manufacture including profits, if any, which the assessee would have normally earned on the sale of such goods;

(c) where the assessee so arranges that the excisable goods are generally not sold by him in the course of wholesale trade except to or through a related person and the value cannot be determined under clause (iii) of the proviso to clause (a) of sub-section (1) of Section 4 of the Act, the value of the goods so sold shall be determined--

(i) in a case where the assessee sells the goods to a related person who sells such goods in retail, in the manner specified in clause (a) of this rule;

(ii) in a case where a related person does not sell the goods but uses or consumes such goods in the production or manufacture of other articles, in the manner specified in clause (b) of this rule:

(iii) in a case where a related person sells the goods in the course of wholesale trade to buyers, other than dealers and related

persons, and the class to which such buyers belong is known at the time of removal, on the basis of the price at which the goods are ordinarily sold by the related person to such class of buyers". (Emphasis supplied)

Rule 7 is the residuary section in the sense that if the value of excisable goods cannot be determined under Rules 4 to 6, the proper officer is required to determine the value of the excisable goods according to the best of his judgment, and for this purpose, he "may have regard, among other things, to any one or more of the methods provided for in the foregoing rules". Thus the basic principle relating to the assessable value of manufactured goods is normally the ordinary wholesale price. That is the principle underlying Section 4(1)(a), which principle may also be made applicable to Section 4(1)(b) read with rules 3,5 and 7 of the Valuation Rules. The principle is subject to certain exceptions among them being the qualification that the sale is not to or through a related person as defined in Section 4 (4) (c) of the Act.

In *Ujagar Prints II*, the Constitution Bench was required to consider the correctness of the view taken by three Judges of this Court in *Empire Industries*. In *Empire Industries*, this Court had primarily held that the Central Excise & Salt and Additional Duties on Excise (Amendment) Act, 1980 by which the processes of bleaching, dyeing and printing were brought within the definition of "manufacture" for the purposes of the Central Excise and Salt Act, 1944 and the Addition Duties of Excise (Goods of Special Importance) Act, 1957, was constitutionally competent. While upholding the validity of the Amendment Act this Court had stated:-

"When the textile fabrics are subjected to the processes like bleaching, dyeing and printing etc. by independent processes, (sic) (processors) whether on their own account or on job charge basis, the value for the purposes of assessment under Section 4 of the Central Excise Act will not be the processing charges alone but the intrinsic value of the processed fabrics which is the price at which such fabrics are sold for the first time in the wholesale market".(pg.342) (Emphasis supplied)

In other words the basic principle enumerated in Section 4(1) (a) of the Act was applied to processed goods. The respondents had applied this principle and paid excise duty for the first period taking the price at which the processed goods were first sold in the open market as the assessable value.

M/s. *Ujagar Prints II* affirmed the decision in *Empire Industries* in all respects including the passage quoted earlier. The submission of the independent processors that the assessable value of the processed fabric could comprise only of the processing charges was rejected in the following words:-

"The incidence of the levy should be uniform, uninfluenced by fortuitous considerations. The method of determination of the assessable value suggested by the processors would lead to the untenable position that while in one class of grey fabric processed by the same processor on bailment, the assessable value would have to be determined differently dependent upon the consideration that the processing house had carried out of processing operations on job work basis, in the

other class of cases, as it not unoften happens, the goods would have to be valued differently only for the reason the same processing house has itself purchased the grey fabric and carried out the processing operations on its own". (pg.520)

Therefore, the assessable value of the processed goods, as far as that processor was concerned, would have to be the same irrespective of the fact that it either manufactures the goods and then process it itself or is given the goods and merely undertakes the processing before returning the same to the manufacturer/owner. That common norm was the wholesale price.

This was made abundantly clear by Justice Mukharji, J. (as he then was). He delivered a separate but concurring judgment and was the author of the judgment in Empire Industries. He said:-

"If the trader, who entrusted cotton or manmade fabrics to the processor for processing on job work basis, would give a declaration to the processor as to what would be the price at which he would be selling the processed goods in the market that would be taken by the excise authorities as the assessable value of the processed fabrics and excise duty would be charged to the processor on that basis. Where a manufacturer sells the goods manufactured by him in wholesale to a wholesale dealer at the arms length and in the usual course of business, the wholesale cash price charged by him to the whole sale dealer less trade discount would represent the value of the goods for the purpose of assessment of excise. But the price received by the wholesale dealer who purchases the goods from the manufacturer and in his turn sells the same in wholesale to other dealer, would be irrelevant for determination of the value of the goods and the goods would not be charged on that basis".

\005 It has to be reiterated that the valuation must be on the basis of wholesale cash price at the time when the manufactured goods enter into the open market". (Emphasis supplied).

This was therefore, in terms, an unconditional approval of the ratio in Empire Industries. However on an application filed for clarification of the judgment in M/s. Ujagar Prints II, this Court in a short order in M/s. Ujagar Prints III clarified:-

"\005 it is made clear that the assessable value of the processed fabric would be the value of the grey cloth in the hands of the processor plus the value of the job work done plus manufacturing profit and manufacturing expenses whatever these may be, which will either be included in the price at the factory gate or deemed to be the price at the factory gate as if the processed fabric was sold by the processor". (pg. 531)

This clarification, in fact, was a deviation from the formula approved in Empire Industries. In other words, it was not the wholesale price at the merchant manufacturers stage which

would be the assessable value of the processed goods, but the value of the processed fabrics on the basis of a deemed sale at the factory gate of the processor. The Court went on to say:-

"If the trader, who entrusts cotton or manmade fabric to the processor for processing on job work basis, would give a declaration to the processor as to what would be the price at which he would be selling the processed goods in the market, that would be taken by the excise authorities as the assessable value of the processed fabric and excise duty would be charged to the processor on that basis provided that the declaration as to the price at which he would be selling the processed goods in the market, would include only the price or deemed price at which the processed fabric would leave the processor's factory plus his profit".

\005It is necessary to include the processor's expenses, costs and charges plus profit, but it is not necessary to include the trader's profits who gets the fabrics processed, because those would be post-manufacturing profits".
(Emphasis supplied)

The actual wholesale price was jettisoned in favour of a deemed sale price by the processor to the merchant manufacturer.

The decision in M/s. Ujagar Prints III was construed and followed subsequently by this Court in Pawan Biscuits Company Private Limited V. Collector of Central Excise (2000) 120 ELT 24; (2000) 6 SCC 489 (briefly referred to as Pawan Biscuits). In that case, it was alleged that the assessee was really an agent of M/s. Britannia Industries Limited and, therefore the price at which M/s. Britannia Industries Limited was selling the manufactured goods in the wholesale market was to be taken as the assessable value. The Tribunal's decision was reversed by this Court. It was found that the agreement between the parties indicated that the relationship was one of principal to principal and not principal and agent and also that the assessee could manufacture biscuits of other brands and sell the same. It was observed that the assessee had been established much prior to its agreement with Britannia Industries Limited. In the circumstances it was held that the decision in M/s. Ujagar Prints II and others could not be factually distinguished. The Court proceeded on the basis that the last three lines of the explanatory order in M/s. Ujagar Prints III (which we have quoted earlier) contained the ratio of the decision of both M/s. Ujagar Prints II and III.

In M/s. Ujagar Prints II and III, the assessees were independent processors and the Court proceeded on that factual basis. The appellant's contention therefore is that as the processor (the respondent No.1 in this case) is not independent of the merchant manufacturer or trader, the ratio of M/s. Ujagar Prints III would not apply. In Pawan Biscuits although no conclusion from the facts has been recorded, it is clear that it was the facts which induced the Court to come to the conclusion that the relationship between the assessee and M/s. Britannia Industries Limited was that of an independent processor and a merchant manufacturer and that M/s. Ujagar Prints II and III were factually on all fours. The decision therefore does not take us nearer to a solution of the dispute raised by the appellant.

The contention of the respondents is that neither the show cause notice nor the Commissioner in his order proceeded on the basis that Section 4(1) (a) of the Act applied but that they had applied Section 4(1) (b) and the Valuation Rules. It is their submission that the concept of deemed sale at the processors factory introduced by M/s. Ujagar Prints III, does not strictly fall within Valuation Rules 4 or 5. They urged, and the Tribunals view was, that M/s. Ujagar Prints III applied the procedure prescribed in Rule 6(b)(ii). As we have seen Rule 6(b) deals with excisable goods which are not sold by assessee but "are used" or "consumed" by him or on his behalf in the production or manufacture of "other" articles. In such case, the value of the excisable goods is to be based either (i) on the value of the comparable goods produced or manufactured by the assessee or by any other assessee, or if that is not possible under (ii) on the cost of production or manufacture, including profits, if any, which the assessee would have normally earned on the sale of such goods.

We do not agree that if Section 4(1)(b) is invoked Rules 4 and 5 do not apply. We have already held that Rule 3 does not make any distinction between the rules which may be invoked even when Section 4 (1) (b) is invoked. If none of the rules i.e. 4, 5 or 6, in terms apply, then Rule 7 would. In other words, the sale which is referred to in Rules 4, 5 and 6 may in the circumstances reflect a notional sale and provide a guideline for applying analogous principles mutatis mutandis under Rule 7.

Rule 6(b) relied on by the respondent does not in terms apply. As we have noted, Rule 6(b)(ii) envisages a situation where a manufacturer consumes the manufactured commodity himself for making other excisable articles. But assuming it does in terms apply it is noteworthy that Rule 6(b)(ii) speaks of the excisable value being the cost of manufacture including the profits "normally" earned. Thus, it would still be open to the Revenue to say that the cost of grey fabrics as well as the processed charges were depressed because the parties were related persons. Indeed, the underlying principle of all the Rules as well as Section 4 is that different considerations would apply if the transactions concerned are not at arms length. Neither section 4(1) (b) nor Rule 6(b)(ii) have done away with the concept of "related person".

We therefore do not agree that Ujagar Prints III would apply even to a processor who is not independent and, as is alleged in this case, the merchant manufacturers and the purchasing traders are merely extensions of the processor. In the latter case, the processor is not a mere processor but also a merchant manufacturer who purchases/manufactures the raw material, processes it and sells it himself in the wholesale market. In such a situation, the profit is not of a processor but of a merchant manufacturer and a trader. If the transaction is between related persons, the profit would not be "normally earned" within the meaning of Rule 6(b)(ii). If it is established that the dealings were with related persons of the manufacturer the sale of the processed fabrics would not be limited to the formula prescribed by Ujagar Prints III but would be subject to excise duty under the principles enunciated in Empire Industries as affirmed in Ujagar Prints II, incorporating the arms length principle.

The respondent No.1 assessee had submitted before the Department and before us that if the assessee was not permitted to rely upon the formula laid down in M/s. Ujagar Prints III then it was entitled to discounts and advertisement expenses. These were not allowed by the Commissioner. As the question whether the respondent No.1 would be entitled to discounts and deductions claimed would only arise if it held that the ratio of M/s. Ujagar Prints III would not apply, the Tribunal

did not address this aspect of the matter at all nor did it consider whether the merchant-manufacturers and the respondent No.1 were related persons. Since the Tribunal, in our opinion, wrongly upheld the respondent's contention that the formula in M/s. Ujagar Prints III would apply in full measure, it is now necessary for the Tribunal to consider whether the respondents were related persons and whether the respondent No. 1 would be entitled to claim discounts or could exclude the advertisement expenses incurred by the dealers. We therefore allow the appeals and remand the matter back to the Tribunal for the purpose of determining the nature of the alleged relationship between the respondent No.1 and the other respondents. If it is found that the respondents are not related persons then the earlier decision of the Tribunal will stand. If on the other hand it is found that the respondents are related, the Tribunal will consider the questions of discounts and deductions claimed by the respondents before remanding the matter to the Commissioner for a correct computation of the calculation errors. No order as to costs.