

Telco Vs. Commissioner of Central Excise

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Court : Customs Excise and Service Tax Appellate Tribunal CESTAT Mumbai

Decided On : Jan-02-1998

Reported in : (1998)(101)ELT689Tri(Mum.)bai

Appellant : Telco

Respondent : Commissioner of Central Excise

Judgement :

1. The appellant is a manufacturer of motor vehicles. It uses a large number of components for such manufacture. It is stated that before any raw materials are issued for manufacture out of any particular batch the parts are subjected to what is described as destructive testing.

These parts are subjected to stresses and strains in order to test their tensile strength and other qualities upto a point where the stress on them is greater than they have withstood, and they break or get so distorted that they cannot be put to use. After testing the remnants of these parts are cleared as scrap on payment of duty appropriate to scrap. The appellant had taken Modvat credit of the duty paid on these inputs. The department was of the view that the conversion of the parts which were tested into scrap did not take place during the course of manufacture and that therefore the benefit of Sub-rule (1) of Rule 57D will not be available to these goods. Notice was issued demanding recovery of the duty equal to the credit taken.

This was resisted on the ground that such testing was essential for manufacture and that without such testing the appellant could not ensure the quality requirement of its finished products. The Assistant Collector did not accept these contentions in his order which has been confirmed by Collector (Appeals). Hence this appeal.

2. The representative of the appellant contends that testing is which these parts indicate is essential for manufacture of the goods. It is only by such testing that the manufacturer satisfies himself that the components of a particular batch are of the required quality and suitable for manufacture of the marketable finished commodity. He says that decisions have decided the issue in his favour. He further says that Sub-rule (2) of Rule 57F, as it stood at the relevant time permitted a manufacturer to remove inputs outside the factory for test without payment of duty. It would be illogical to say that, while the inputs could be removed outside the factory it could not be within the factory. He relies upon the following decisions in support of his case. Collector of Central Excise v. Rajasthan State Chemical Works - 1991 (55) E.L.T. 444 3. The departmental representative says that provisions of Rule 57D would apply in a situation where waste arises during the manufacture of the goods. In the present case when the goods were tested they had not yet entered the stream of manufacture. He contends that Rule 57F contemplates return to the factory of the goods tested for use in the finished product. He seeks to rely on two decisions cited by the appellant.

4. Sub-rule (1) of Rule 57D provided that credit allowed in respect of any inputs shall not be denied on the ground that part of the inputs is contained in any waste, refuse or product arising during manufacture of the final product. What we have to see is whether the destructive testing which results in goods being rendered non-usable for manufacture takes place during the manufacture of the final product. It was emphasized by the appellant's representative that testing was undertaken in order to ensure that the quality of the components, of which a sample was tested, was such that they could be used to manufacture the final product of the required quality. It would follow from this that if the destructive testing with the samples revealed that the batch was unsuitable, it would not be issued for manufacture.

A question was put to the representative of the appellant on this specific point and he confirmed that this was the practice followed.

Let us consider a situation where the goods when tested prove not to be of the required standards. In that case, the entire batch of components would not be used for manufacture. It was stated that in that case the goods are returned to the supplier as rejected. If there is only one batch of a particular component which is tested and found to be unsuitable, the manufacture in the appellant's factory would come to a stop. In other words, the process of testing in the present case is to ensure that the parts of which a sample is tested are suitable for being taken for manufacture. Manufacture involving these parts would not commence till the components are found suitable after test and issued for manufacture. The testing therefore takes place not during the manufacture, but at a stage prior to it. We have to distinguish this from a situation where the parts became damaged or unusable in the course of manufacture. This would be in a situation where the parts have entered the stream of manufacture, and in the course of one of the operations which totally constitute manufacture become unfit or unstable for use.

5. The words used in Sub-rule (1) of Rule 57D are different from the words in Rule 57A. The latter refers to inputs which are used in or in relation to the manufacture of final products. The words used in Sub-rule (1) of Rule 57D are waste etc. "arising during the course of manufacture of the final product". Both this expression is wider in scope than the term "during the manufacture". The term "in relation to manufacture" would cover a number of items which may not directly be used in the manufacture of the finished product but would contribute to such manufacture. By using the words "arising during manufacture" Rule 57D is restricted to such waste or by product which arises during any of the processes each of which directly is a part, of the manufacture.

It would cover parts etc. in processes which are immediately necessary for manufacture, but not those which are in processes which are not immediate, but may contribute towards such manufacture.

5. In CCE v. Rajasthan State Chemical Works the Supreme Court was concerned with interpretation of Notification 179/77 which exempted goods falling under Item

68 of the tariff "in or in relation to the manufacture of the finished goods no processes is ordinarily carried on with the aid of power." This decision would not apply to interpretation of Rule 57(D)(1). In *Union Carbide v. CCE* the issue for decision was whether batteries which, after manufacture, were found to be defective and hence destroyed would be covered by the provisions of Sub-rule (1) of Rule 57D. The Bench held that batteries said to have been manufactured till after the final testing had relied on the department with instructions to this effect that the RG 1 for batteries was after final testing. The facts are obviously different from those in the present case. In *Prem Pharmaceuticals v. CCE* the appellant before the Tribunal manufactured intravenous fluids which were packed in glass bottles. The issue for decision was whether Sub-rule (1) of Rule 5 would apply to such bottles which break when being washed and cleaned.

The Tribunal said that washing and cleaning were necessarily related to ensure the margins of the final product to conform to U.S. Pharmacopial standards and that therefore they were an integral part of the manufacturing process. The issue for decision in *Glindia Ltd. v. CCE* was very similar.

6. It would be noted in these three decisions, the damage to the product was indisputably during manufacture. In *Union Carbide* it was before the finished product had reached the marketable stage. In the other two cases it was the containers which are without dispute necessary for packing the final product, which became scrap on the assembly line i.e. during the processes which formed part of the manufacture. In the present case the testing is clearly anterior to the manufacture. Therefore these decisions will not apply. The decisions in *Hindalco industries Ltd.* relates to the Modvat credit on laboratory chemicals and involves interpretation of Rule 57F(A) and not Sub-rule (1) of Rule 57D.7. Reliance upon Sub-rule (2) of Rule 57F does not also help the appellant's case. This rule provides that the inputs which are sent out by the factory for any of the purposes specified, without are returned to the factory for further uses in the course of manufacture of the final product without payment of duty and again for export. Therefore a condition of this rule that its input must be returned to the factory after test or completion of the other processes. If the input is destroyed or consumed during these processes, duty would become payable under Sub-rule (1).

8. An argument was raised that Sub-rule (1) of Rule 57D was amended in November, 1993 so as to include inputs which had become waste in or in relation to the manufacture of the goods and this amendment has retrospective application. By this amendment in 1993 the following clause was inserted to the existing rule "although the inputs had become waste in or in relation to the manufacture of the final product". By using the word "in or in relation to the manufacture of the final product" the amendment broadens the scope so as to bring it in line with Rule 57A and Sub-rule (1) of Rule 57D. Perhaps the amendment may have been made in order to provide relief to manufacturers in situations of the kind as in this appeal but I do not see how, because of this it becomes retrospective. The addition of a specific clause to the existing rule shows that there was a specific intention to enlarge the scope of the rule. Such an amendment therefore cannot be considered to be clarificatory and therefore retrospective.

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