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Court : Customs Excise and Service Tax Appellate Tribunal CESTAT Delhi

Decided On : Mar-12-1987

Reported in : (1987)(12)LC8Tri(Delhi)

Appellant : Pilco Pharma

Respondent : Collector of Central Excise

Judgement :

1. The appellants manufactured patent and proprietary medicines at Kanpur. In dispute in this appeal is the question as to what was the normal price for assessment of their goods to Central excise duty.

2. The adjudicating Collector has held them guilty of short-payment of duty through fraudulent mis-declaration of the value of their goods, and ordered them to pay the differential duty of Rs. 1,73,269.28 Under Rule 9(2) of the Central Excise Rules, 1944 for the period of 5 years (1978-79 to 1982-83) and has further imposed a penalty of Rs. 4 lakhs on them Under Rule 173Q of the same Rules.

3. During the hearing before us, the appellants first raised a couple of legal pleas, namely; (1) that there was violation of the principles of natural justice inasmuch as the 60 and odd retailers whose statements were relied on by the department against them were not produced for cross examination by the appellants even though asked for at the stage of adjudication, and (2) the demand for differential duty, though made Under Rule 9(2), was, in fact, a demand for the duty allegedly short-paid for the recovery of which a specific provision existed under Section 11A

of the Central Excises and Salt Act, 1944 and hence Rule 9(2) was inapplicable; under Section 11 A, the Assistant Collector alone was competent to adjudicate upon a demand for short levy and the impugned adjudication order passed by the Collector in so far as it related to the demand for short levy, was out of jurisdiction.

However, in the same breath, the appellants added that they did not desire a remand of the matter. They requested that we should decide the case on merits.

4. Thereupon, we took up consideration of the merits of the case and heard both sides on merits. We have since given our earnest consideration to the submissions made by both sides and the record of the case. The material facts, on which the decision of the point in dispute depends, have come out as under:- (1) Most of the 60 and odd retailers, whom the appellants claimed to have sold the goods at the factory gate, have, in their statements recorded by the departmental officers, denied having purchased any medicines manufactured by the appellants. A few of them admitted having purchased such medicines but from M/s Gulati Traders of Kanpur and not from the appellants.

(2) For Delhi area, all sales of the appellants' medicines were made to M/s K.K. Traders of Delhi. The Collector has held that this firm was an independent party in the sense that it was not a 'related person' of the appellants within the meaning of Section 4(4)(c) of the Central Excises and Salt Act, 1944. Yet, the Collector held that the sale, price charged by the appellants from M/s K.K. Traders could not be the normal price on the ground that the sales to this firm were negligible (about 1% only) and were only a facade of "independent sales" created to enable the appellants to depress the assessable value of their goods and thereby evade payment of a part of the Central Excise duty. The learned representative of the department reiterated this contention and placed reliance on the Karnataka High Court judgment at, 1978 ELT (J564). State of Karnataka v. Union of India & others and the Supreme Court judgment at 1985 (59) S.T.C. 277 - McDowell and Company.

(3) The remaining sales (about 99%) of the appellants' medicines were made to or through M/s Gulati Traders of Kanpur. This firm sold the medicines manufactured by the appellants alone and of no other manufacturer. This firm was the sole

distributor of the appellants' medicines for the whole of India except Delhi area. All the four partners of the firm were close relatives of the appellant firm and they came within the definition of 'relative' as in the Companies Act, 1956. The Collector held that M/s Gulati Traders of Kanpur were a 'related person' of the appellants within the meaning of both parts of Section 4(4)(c). For the first part of the definition, the Collector held existence of mutual business interest of the two firms as proved on the ground that the appellants had made over two Matador Vans to M/s Gulati Traders for use in the latter's sales activity. The appellants stated before us, but no such fact is recorded in the impugned order-in-original, that they had collected rentals for the vans for three out of the five years for which the Collector has issued the duty demand. In the Show Cause Notice, besides the vans, two other grounds of mutual business interest had been set out, namely, (i) employment of three agents by M/s Gulati Traders for procuring sales orders for the appellants' medicines, and (ii) expenses incurred by M/s Gulati Traders on advertisements of the appellants' medicines. However, during the adjudication the Collector dropped these two other grounds holding that these two activities promoted the sales of M/s Gulati Traders also with a view to giving them larger profits. The Collector further held that the second part of the definition of 'related person' was also proved because, all the partners of M/s Gulati Traders being close relatives of the partners of the appellant firm, M/s Gulati Traders were both "a relative and a distributor of the assessee". The Collector rejected the argument of the appellants that the two firms should have been related to each other and not the individual partners of the firm. The Collector held that a partnership firm was nothing but a sum total of its partners and that it was not a legal person like a limited company. Secondly, the Collector held, the firm not being a person or human being could not have relatives; the partners alone could have relatives. Before us, the appellants relied on the judgment of this Tribunal at 1983 ELT 1994 - G.D. Industrial Engineers - in which two partnership firms with identical partners had been held as two separate persons (their shares in the two firms varied). The appellants also placed reliance on 1978 ELT 317 (SC) - Assistant Collector of Central Excise & Customs v. Shri J.C. Shah and Ors. and - 1986 (24) ELT 186 (SC) - Deputy Commissioner of Sales Tax (Law) v. K. Kelukutty - which has been cited in this Tribunal's judgment at 1987 (27) ELT 477 (Tribunal) - Minichem India.

5. The appellants further contended that the duty demand had been inflated as the department had not allowed even the obvious deductions of central excise duty and sales tax from the sale price of M/s Gulati Traders.

7. We find that the issue before us is not whether M/s Pilco Pharma, Kanpur and M/s Gulati Traders, Kanpur were one firm or two separate firms or whether one worked by or on behalf of the other. The Supreme Court judgments in the cases of J.C. Shah and K. Kelukutty and this Tribunal's judgment in the case of Minichem India aforesaid, relied on by the appellants, are, therefore, not relevant for disposal of the instant appeal. The issue before us is whether M/s Gulati Traders were 'related person' of the appellants or not. The Collector has held that they were a related person and he has, consequently, ordered assessment on the basis of the sale price of the related person, i.e., M/s Gulati Traders, in terms of proviso (iii) to Section 4(1Xa). This proviso reads as under:- "(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;" 8. Two conditions must be satisfied before the above proviso can be invoked - (b) the assessee should be selling his goods generally to or through such related person.

As regards the first condition, the Act itself defines as to who is a related person. We reproduce below the relevant section 4(4)(c) and also the definition of "relative" as in the Companies Act, 1956:- (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, a relative and a distributor of the assessee and any sub-distributor of such distributor.

Explanation. - In this Clause 'holding company', 'subsidiary company' and 'relative' have the same meanings as in the Companies Act, 1956 (1 of 1956)." (4) 'relative'

means, with reference to any person, any one who is related to such person in any of the ways specified in section 6, and no others; 6. MEANING OF RELATIVE - A person shall be deemed to be a relative of another if, and only if, (c) the one is related to the other in the manner indicated in Schedule 1A x x x x 9. It was not contested by the appellants before the Collector, nor before us, that all the partners of M/s Gulati Traders were relatives of the partners of M/s Pilco Pharma within the meaning of the term as in the Companies Act. Now, it is clear that when one talks of father, mother, son, daughter or brother etc. with reference to human affairs, the reference is to relationship between human beings, A firm cannot be the father or mother of another firm. To insist that two firms should be so related and no the individual partners comprising them, as the appellants do, is to ask for the impossible. That would render the later part of section 4(4)(c) nugatory except in relation to two proprietory units. We find no warrant for saying that two units owned by father and son, respectively, are 'relatives' but two firms owned by father and mother, on the one hand, and by mother and son, on the other, are not 'relatives'. The relationship of father, mother, son, brother etc. has got to be determined in relation to the individual partners comprising the two firms, as the Collector has done. By that test, we hold, M/s Gulati Traders were a 'relative' of the assessee, M/s Pilco Pharma.

10. It is no longer in dispute that M/s Gulati Traders were the appellants' distributor for the whole of India except Delhi area. They were, therefore, "a relative and a distributor of the assessee" within the meaning of section 4(4)(c).

11. We find that the facts of the case justify classification of M/s Gulati Traders as a 'related person' of the appellants even according to the test laid down in the first part of the definition in section 4(4)(c) inasmuch as there was financial involvement of the two firms in the business of each other. The appellants had given their two Matador vans to M/s Gulati Traders for which, even according to the appellants themselves, no rental was charged for atleast two out of the five years under dispute. On the other side, M/s Gulati Traders incurred expenses on advertisement of the appellants' products. Advertisement and publicity are activities which rightly belong to the manufacturer as they make his goods marketable and promote their sales. On that ground, the Supreme Court have held

that advertisement expenses are includible in the assessable value of the goods 1983 ELT 1896 (SC) - Bombay Tyre International]. Mutuality of interest between the two firms was there, beyond doubt.

12. Coming to the second condition of proviso (iii) to Section 4(1)(a) now, the Collector has found that 99% of the appellants' goods were sold to or through M/s Gulati Traders. He has held after investigations that the gate passes and invoices made by the appellants in the name of 60 and odd retailers were fake and were a feverish attempt on the part of the appellants to create a facade of independent sales at the factory gate so as to get away with a lower assessable value. The appellants were supplied with copies of the statements given by these 60 and odd retailers to the departmental officers. The appellants have a grievance that these retailers were not produced for cross-examination by them before the Collector. At the same time, they do not want a remand of the matter to the Collector for a fresh adjudication but want us to decide it on merits. In the circumstances, when all the retailers, with one voice, deny having purchased any medicines from the appellants, we cannot brush their statements aside.

Even assuming, for the sake of argument, that the appellants did make direct sales to these retailers at the same price at which they sold their products to M/s Gulati Traders and M/s K.K. Traders, the quality sold by them to these retailers, 'according to their own statement before us, was no more than 15%. It would only mean that they sold about 84% of their goods to or through the related person, M/s Gulati Traders, and no 99%. That would make no difference to the conclusion that their goods were generally sold in wholesale to or through the related person only. Both the conditions of proviso (iii) to section 4(1)(a) were thus satisfied and the Collector was justified in determining the assessable value under this proviso. The proviso does not require that all the hundred percent sales should be to or through the related person. It is enough if they are generally" so, the small number of independent sales notwithstanding.

13. We feel fortified in our conclusions by the Supreme Court judgment at 1986 (23) E.L.T. 3 (SC) - Mohan Lal Maganlal Bhavsar and others v.Union of India and others which was cited by the learned representative of the department. In that

case, there were to separate partnership firms the manufacturing firm and the chief distributor firm. The three partners of the manufacturing firm along with a son of each of them were also the partners of the chief distributor firm. From this fact, the Supreme Court observed that there was "identity of interest" between the two firms. There were certain additional circumstances also in that case. The chief distributor firm had their offices in the same premises as the manufacturing firm and the sons of the three partners of the manufacturing firm were to share only in the profits of the chief distributor firm but not to be liable for any losses. The Supreme Court concluded that the two firms could not said to be at arm's length or independent parties and the prices at which the goods were sold by the manufacturing firm to the chief distributor firm could not be taken to be the real value of the goods. In the case before us also, not only the partners of the distributor firm were closely related to the partners of the manufacturing firm but there were additional circumstances also in the form of the manufacturing firm giving its motor vehicles free to the distributor firm and the distributor firm incurring expenses on advertisement of the goods produced by the manufacturing firms.

14. While we confirm the basis of valuation as adopted by the Collector, the calculations of the demand for duty would appear to require another look by the Collector. The appellants stated before us that such obvious deductions as central excise duty and sales tax had not been allowed from the gross sale price of M/s Gulati Traders. If it is really so, it is a violation of the specific provision of Section 4(4)(d)(ii) and the Collector Should set it right immediately.

15. While imposition of the penalty on the appellants Under Rule 17sc was legal and fully justified by the facts of the case, the amount of penalty of Rs. 4 lakhs is excessive as it is more than double the amount of the duty sought to be evaded even according to the calculations already made. We reduce the penalty to Rs. 1 lakh only.

16. But for the reduction in the amount of penalty as ordered in the preceding paragraph and the possible re-calculation of the duty demand as ordered in paragraph 14 above, the appeal is otherwise dismissed.

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