Collector of Central Excise Vs. J.K. Cotton Spinning and Weaving

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Court : Customs Excise and Service Tax Appellate Tribunal CESTAT Delhi

Decided On : Mar-22-1988

Reported in : (1988)(16)ECC105

Appellant : Collector of Central Excise

Respondent : J.K. Cotton Spinning and Weaving

Judgement :

1. This is.a reference application filed by the Collector under Section 35E(1) of the Central Excises & Salt Act, 1944 on the direction of the Central Board of Excise & Customs. As per Sub-section (4) of Section 35E, the application is required to be heard and disposed of by this Tribunal as if it were an appeal.

2. The respondents are a textile mill. The dispute in this deemed appeal is on what should be the value of the superfine cotton fabrics and man-made fabrics manufactured by the respondents and cleared during the period from November 1978 to March 1986.

3. The facts, in brief, are that the respondents sold their fabrics through their sister company, M/s. 3.K. Commercial Corporation Limited, who acted as the Sales Managers or selling organisation of the respondents. The respondents sold their entire out-put of the fabrics to four partnership firms of Kanpur : The partners of these firms were closely inter-related. These four firms, in turn, sold the entire out-put to only one customer, M/s.

Agarcon (India) Ltd., Kanpur. The four firms and M/s. Agarcon were located in the same building. The four firms had no godown or storage space of their own. The goods were carted from the respondents' factory and were unloaded directly at M/s. Agarcon's premises. There was no written agreement either between the respondents and the four firms or between the four firms and M/s. Agarcon. The four firms purchased the goods on the basis of 45 days' Hundi and for the period of credit they paid the interest separately, over and above the sale price of the fabrics. They added their own commission or profit - ranging from nil to 7% -on the respondents' invoice price and re-billed it to M/s.

Agarcon, citing reference to the respondents' original bill. They sold the fabrics to M/s. Agarcon for credit for 45-60 days but charged no separate interest for it. M/s. Agarcon and one of the four firms monitored designs and patterns for fabrics, for which the customer demand existed, and conveyed it to the respondents.

4. The show cause notice was issued by the department on 15-5-1979 on the footing that M/s. Agarcon were the sole distributor of the respondents in terms of Section 4(4)(c) of the Act, that the goods manufactured by the respondents entered the first purely commercial stream of wholesale trade only when M/s. Agarcon sold them to wholesale dealers and hence the goods were liable to be assessed at M/s.

Agarcon's re-sale price in terms of proviso (iii) to Section 4(1)(a) of the Act and differential duty was accordingly chargeable from the respondents. On adjudication, the Collector dropped the proceedings holding that dealings between the respondents and the four buyer firms and between these four firms and M/s. Agarcon were on principal to principal basis and that M/s. Agarcon were not a related person of the respondents. The Central Board of Excise and Customs called for and examined the records of the case in terms of 35E(1) and was of the view that the order passed by the Collector was not legal and proper. The' Board made a detailed order to this effect and directed the Collector to apply to this Tribunal tor the determination of the points arising out of the Collector's order and as specified in the Board's order. The Board was of the view that the four buyer firms of the respondents ought to be declared as existing only on paper or at the most existing only as commission agents and M/s. Agarcon also existing as commission agents or, alternatively, as a related person of the respondents under the first part of Section 4(4)(c). Accordingly, the Board wanted the fabrics manufactured by the respondents to be assessed on the basis of M/s. Agarcon's sale prices. Thereupon, the Collector made the instant application which, as already stated, is being disposed of by us as an appeal.

(1) the Board had not specified the points arising out of the Collector's order-in-original which required determination by the Tribunal; and (2) the point made in the Board's order that M/s. Agarcon functioned as the commission agent of the respondents did not arise out of the Collector's order since it was neither raised before the Collector in the show cause notice nor did the Collector deal with it in his order.

We heard both parties on these preliminary points. We found that the Board had dealt with the facts of the case and the issues involved at great length in sub-paras (a) to (z) of paragraph 3 of their order. The points which the Board wanted to be determined by the Tribunal, though not itemised separately as 1, 2, 3, 4, were nevertheless stated in sub-paras (x) & (z) of the Board's order. Sub-para (x) stated that M/s.

Agarcon sold the goods "on behalf of" the respondents; in other words, M/s. Agarcon were a commission agent of the respondents. Therefore, M/s. Agarcon's sale price in the wholesale market should be taken as the basis of valuation under Section 4(1)(a). Sub-para (z) stated that M/s. Agarcon were a related person of the respondents within the meaning of the first part of Section 4(4)(c), the consequence of this also being that sale price of M/s. Agarcon should form the basis of assessment in terms of proviso (iii) to Section 4(1)(a). We are, therefore, satisfied that the Board's order substantially complied with the provisions of Section 35E(1) and there is no force in the first preliminary objection of the respondents. However, we find force in the second preliminary objection of the respondents. No doubt, in paragraph 12 of the show cause notice, the respondents were called upon to explain why M/s. Agarcon should not be considered their "agent/ distributor". But this explanation was called for from the respondents in the context of Section 4(4)(c) and proviso (iii) to Section 4(1)(a), that is, in the context of the allegation that M/s. Agarcon were a related person of the respondents and not that they were a commission agent of the respondents. The word "agent" was used in the expression "agent/ distributor" to convey that M/s. Agarcon were being alleged to be a sole selling agent/distributor of the respondents and not as commission agent/ distributor of the respondents.

6. However, as the hearing progressed, there was no need left for us to pronounce formally on the second preliminary objection of the respondents. The department itself realised that a person could not be a commission agent and a related person at one and the same time. If he paid for the goods, he was not a commission agent. If he did not, he could not be a related person. The evidence in this case was that M/s.

Agarcon purchased the goods from the four firms on payment and the property in the goods thereupon passed on to M/s. Agarcon. There was no evidence to show that the goods were being stock transferred to M/s.

Agarcon for sale on behalf of the respondents on commission basis.

Considering the state of evidence, the department stated before us that it was dropping the point that M/s. Agarcon were a commission agent of the respondents.

7. We then took up consideration of the other point specified by the Board, namely, whether M/s. Agarcon could be regarded a related person of the respondents. Since both the respondents and M/s. Agarcon were limited companies and hence separate legal entities, they could not obviously be regarded as a 'relative' of each other within the meaning of second part of Section 4(4)(c). As held by the Hon'ble Supreme Court in their judgment in the case of Bombay Tyres International Limited [1983 ELT 1896 (SC)J, the fact that they were a distributor of the respondents' goods, was by itself not adequate to make them a related person; the requirement of the second part of Section 4(4)(c) was that the distributor should be a relative of the assessee also. This condition was not specified in this case. It is not the case of any party before us that M/s. Agarcon were a related person of the respondents within the meaning of the second part of

Section 4(4)(c).

The point put before us is whether they were a related person of the respondents within the first part of that Sub-section. Regarding the first part, it has been held by the Hon'ble Supreme Court in Union of India v. Atic Industires Limited [1984 (17) ELT 323 (SC)] that to satisfy the definition of the first part there should be mutuality of interest, direct or indirect, in the business of each other -between the assessee and his buyer. We asked the department to show as to what was the mutuality of interest as between the respondents and M/s.

Agarcon in this case. We were informed that there was no shareholding as between the respondent company and M/s. Agarcon. We were further informed by the respondents that no partner of the four firms had any shareholding either in the respondent company or in M/s. Agarcon. At this, the learned advocate of the department stated that he would not argue his point that the price at which M/s. Agarcon re-sold the fabrics should form the basis of assessment. This amounted to saying that he would not argue that M/s. Agarcon were a related person of the respondents under Section 4(4)(c), because the question of assessing the goods on the basis of M/s. Agarcon's re-sale price could arise in terms of proviso (iii) to Section 4(1)(a) only if M/s. Agarcon were regarded a related person of the respondents. The learned advocate of the department did not elaborate it further. However, he mentioned two features : (1) M/s. Agarcon paid no interest for their purchases although they paid for them after 45-60 days from the date of delivery of the fabrics to them; and (2) M/s. Agarcon supplied fashion/design feed-back free of charge to the respondents.

The learned advocate of the department agreed that though these two features might not suffice to prove mutuality of interest between M/s.

Agarcon and the respondents they nevertheless showed that M/s. Agarcon were also a part of the total arrangement made by the respondents and they fell into the sales pattern of the respondents.

8. We do not find substance in either of these two features relied on by the department. It is not correct to say that M/s. Agarcon were enjoying credit facility of

45-60 days but they paid no interest for it. In business, nothing is done for nothing. Though M/s. Agarcon did not pay any interest separately, the interest element was built into the price they paid for the goods. When the four firms sold the goods to M/s. Agarcon, the firms added their own commission to arrive at the price. This commission ranged from nil to 7%, depending upon what the traffic could bear in the market conditions at the time. The four firms paid interest for their purchases on credit. In spite of the interest payment, they made profit at the end of the year. This shows that their own margin added to their sale price was adequate to cover the interest charges and yet give them an overall profit. Thus the total price which M/s. Agarcon paid to these four firms already had the interest element built into it.

9. As regards the fashion/design feed-back, the respondents stated that there was no obligation cast upon M/s. Agarcon to supply any such information nor was the supply of such information a consideration for sale of the fabrics to M/s. Agarcon. We were told that there were no written agreements either between the respondents and the four buyer firms or between these four firms and M/s. Agarcon. The whole thing worked on the basis of some understanding between the parties. The respondents stated that they had a vast research and development organisation of their own to ascertain the customer's choice and demand pattern for the fabrics from time to time. They had entrusted this work to their sister company, M/s. J.K. Commercial Corporation Ltd., who also acted as their selling organisation. For their services, the respondents paid that company 1-1-1/2% of the sale value plus travelling expenses. The respondents were including this commission in their sale price and there was no dispute about it. But since M/s.

Agarcon, their dealers and retailers were in the actual sale business and came in touch with the consumers, they were able to sense the consumer's choice. The customers who came to the cloth shops showed their preference for particular shades, prints and designs etc. The retailers and the dealers also knew as to what were the fast moving items at particular items in particular areas. They conveyed this knowledge to the wholesaler who in turn conveyed it to M/s. Agarcon in the course of their day-to-day business. Neither M/s. Agarcon, nor the wholesaler nor the retailers down the line had to make any special efforts or to incur any extra expense for getting this knowledge; it came to them in the course of their normal day-to-day trade. And it was in the interest of every one down the line, right from the respondents to the retail cloth shops, to see that they got fast moving items which gave them the maximum profits and that they were not stuck with un-sold stocks of unpopular designs and patterns. We see the point in the respondents' pleading. The trade in textiles is such that fashions differ from area to area and they also change fast from time to time.

If M/s. Agarcon, their dealers and the retailers collected the feed-back on fashions/patterns, they did it without any extra effort or cost and in the mutual interest of the parties in the business. M/s.

Agarcon could not be regarded a related person of the respondents for this feed-back which, at best, supplemented the information regularly collected by the respondents' selling organisation. It was then pleaded on behalf of the department that the feed-back supplied by M/s. Agarcon should atleast be regarded as an additional consideration for the sale of fabrics to them and money value of such additional consideration be added to M/s. Agarcon's purchase price to make it a fully commercial price in terms of Rule 5 of the Central Excise Valuation Rules, 1975.

But since the respondents vehemently denied that there was any obligation on the part of M/s. Agarcon to supply the feed-back nor is there any evidence to convince us that M/s. Agarcon incurred any extra expenditure to collect and supply the feed-back, and since the department is not able to controvert the respondents' plea, we fail to see how the supply of feed-back could be considered an additional consideration for sale of the fabrics to M/s, Agarcon.

10. We do find substance, however, in the department's pleading that the four firms which came in between the respondents and the sole-distributor, M/s. Agarcon, were mere shadows. These firms had virtually no funds of their own. Their investment ranged from nil to Rs. 5 lakhs only while their turn-over was in crores of rupees. They had no godown or storage place of their own. All that they did was to cart away the goods from the respondents' factory and unload them directly at the premises of M/s. Agarcon. All the four firms were located in Kanpur,

the same place where the respondents' factory was situated. M/s. Agarcon were also located in Kanpur. The business premises of the four firms as well as M/s. Agarcon were situated in the same building. These four firms dealt with the fabrics manufactured by the respondents alone. All the four firms, in turn, sold the entire goods to only one party -M/s. Agarcon. This is most un-usual and odd.

Though one could explain away this or that feature about these firms individually, it is difficult for us to believe that the phenomenon of all the four firms selling the entire out-put to just one customer was something normal. We do not mean to say that the four firms were non-existent or were dummies or that their purchase and re-sale transactions were fictitious. The firms, no doubt, existed but they were, in reality, no more than mere carting igents or lorry contractors. In reality, M/s. Agarcon were the respondents' sole selling agents in India and the goods were directly delivered to them on removal from the respondents' factory. It was M/s. Agarcon who marketed the goods further all over India. The four firms were deliberately created in between as a colourable device. The respondents pleaded that they did not want to deal with just one customer, M/s.

Agarcon, as they did not consider it prudent to put all their eggs in one basket. We find no substance in this explanation. We have already mentioned that the, investment of the four firms was nil or nominal and, as such, these firms could hardly provide any security worth the name to the respondents. These firms themselves existed only on the credit supplied to them by the respondents and the Bank. If really the respondents did not want to deal with just one distributor, they could have appointed more than one distributor. Many of the manufacturing companies do so. The explanation offered by the respondents does not convince us. We hold that the four firms were only shadows and their purchase and re-sale transactions were only paper transactions which could not be accepted as the basis of normal price ordinarily charged in the course of wholesale trade under Section (1)(a) 11. The respondents contended that the point - that the four firms were mere shadows - did not arise from the Collector's order nor was this point specified in the Board's reference order. We do not agree with the respondents. There is a very extensive discussion on this point in both these orders. Whereas the Collector has concluded that the dealings between the respondents and the four firms were as from principal to principal, the Board was of the tentative view that the four firms were not real buyers and sellers. We hold that the point did arise out of the lower orders.

12. Having omitted the paper transactions of the four intermediaries, we come to the purchase price paid by M/s. Agarcon. The goods were, in fact, delivered straight from the respondents' factory to M/s. Agarcon.

The price which M/s. Agarcon paid for the goods could be rejected only for two reasons - either M/s. Agarcon should have been proved to be a related person of the respondents or it should have been proved that the price which M/s. Agarcon paid for the goods was not the sole consideration for the sale. We find no evidence on record to reach either of these two conclusions. Even the department conceded that M/s.

Agarcon were a genuine party. The point really pressed for by the department before us was that the price at which M/s. Agarcon purchased the fabrics should form the basis of assessment. The department, of course, also pressed for adding to it the additional consideration for fashion/pattern feed-back. We have already held that there was no justification to add any such additional consideration. In the result, the purchase price of M/s. Agarcon comes out as the acceptable basis for computation of the assessable value.

13-17. The respondents submitted that if M/s. Agarcon's purchase price was to be taken as the basis, cost of transport from the respondents' factory gate to the premises of M/s. Agarcon and the interest for 45-60 days credit enjoyed by M/s. Agarcon from the date of removal of the fabrics from the factory should be deducted from such price. As the respondents' plea was covered by the Supreme Court judgments in the cases of M/s. Bombay Tyres International Limited - [1983 ELT 1896 (SC)] and M/s. MRF Ltd. - [1987 (27) ELT 553 (SC)], the learned advocate of the department had no objection to these deductions being made from M/s. Agarcon's purchase price after due verification and quantification by the Collector. We find the respondents' plea acceptable.

(1) The four firms acting as intermediaries between the respondents and M/s. Agarcon were mere shadows. The price at which the respondents sold the goods to these firms was not acceptable as the normal price of the fabrics under Section 4(1)(a) of the Act.

(2) The respondents' fabrics really entered the stream of wholesale trade when they were sold to M/s. Agarcon. M/s. Agarcon were neither a commission agent not a related person of the respondents. The purchase price paid by M/s. Agarcon for the fabrics was, therefore, acceptable as the basis for determination of assessable values of the fabrics under Section (3) No addition is required to be made to M/s. Agarcon's purchase price on account of any design/fashion feed-back voluntarily supplied by them to the respondents.

(4) From M/s. Agarcon's purchase price, deduction should be made of the amount, to be quantified by the Collector after due verification, attributable to (i) cost of transport from the respondents' factory gate to the premises of M/s. Agarcon, and (ii) interest charges for the credit period enjoyed by M/s. Agarcon from the date of removal of the goods from the respondents' factory.

19. In the result, we set aside the order-in-original of the Collector and direct him to re-determine the assessable values, and the consequential liability of the respondents to differential duty, if any, in the light of our orders in the preceding paragraphs. The reference application is disposed of accordingly.