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Non-money consideration

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This document contains a brief on non-money consideration

Loss making companies: will amendment of Rule 6 stave off excise duty demands?

The Supreme Court may not have intended this – but its landmark judgment in the Fiat case (CCE versus Fiat India Private Limited, Civil Appeal Nos. 1648-1649) may become a green signal to demand excise duty on the basis of a cost accountant's report in every loss-making company. It is perhaps to allay the panic caused by this prospect that the central government brought in an amendment to Rule 6 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000 (hereinafter referred to as the valuation rules) as part of the annual Budget exercise. Below I look at the valuation provisions in central excise before and after the judgment, in so far as they relate to situations of price that is kept lower than production cost.

Section 4 of the Central Excise Act 1944 governs valuation of goods for the purpose of charging *ad valorem* central excise duties. In terms of this section,

> 1) Where under this Act, the duty of excise is chargeable on any excisable goods with reference to their value, then, on each removal of the goods, such value shall -
> (a) in a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value;
> (b) in any other case, including the case where the goods are not sold, be the value determined in such manner as may be prescribed.

Thus in terms of section 4 the assessable value of the goods, if they are sold, and if price is the sole consideration for sale, will be the transaction value. Transaction value is defined in section 4 as follows:

> "transaction value" means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

In terms of this definition, transaction value includes, not only the price paid by the buyer to the seller, but also any amount paid on his behalf to somebody else. It also includes amounts charged for, or to make provision for marketing expenses and similar costs. This, as we have seen, will be the assessable value when price is the sole consideration for the sale.

If price is not the sole consideration, the value is determined as per Rule 6 of the valuation rules. This rule was recently amended as part of the Budget exercise. Prior to amendment it stood as follows (*sans* the illustrations that form part of the rule):

> **6.** Where the excisable goods are sold in the circumstances specified in clause (a) of sub section (1) of section 4 of the Act except the circumstance where the price is not the sole consideration for sale, the value of such goods shall be deemed to be the aggregate of such transaction value and the amount of money value of any additional consideration flowing directly or indirectly from the buyer to the assessee.
>
> ***Explanation 1 -*** For removal of doubts, it is hereby clarified that the value, apportioned as appropriate, of the following goods and services, whether supplied directly or indirectly by the buyer free of change or at reduced cost for use in connection with the production and sale of such goods, to the extent that such value has not been included in the price actually paid or payable, shall be treated to be the amount of money value of additional consideration flowing directly or indirectly from the buyer to the assessee in relation to sale of the goods being valued and aggregated accordingly, namely:-
> (i) value of materials, components, parts and similar items relatable to such goods;
> (ii) value of tools, dies, moulds, drawings, blue prints, technical maps and charts and similar items used in the production of such goods;
> (iii) value of material consumed, including packaging materials, in the production of such goods.
> (iv) value or engineering, development, art work, design work and plans and sketches undertaken elsewhere than in the factory of production and necessary for the production of such goods.
> ***Explanation. 2-*** Where an assessee receives any advance payment from the buyer against delivery of any excisable goods, no notional interest on such advance shall be added to the value unless the Central Excise Officer has evidence to the effect that the advance received has influenced the

fixation of the price of the goods by way of charging a lesser price from or by offering a special discount to the buyer who has made the advance deposit.
Illustration …

Thus in terms of Rule 6 as it stood before its amendment in July 2014, if there is a non-monetary consideration flowing from the buyer to the seller in addition to the transaction value, the money value of this is added to the transaction value for arriving at the value for assessment to excise duty.

The sum total of the provisions in central excise as regards price as sole consideration and price plus other consideration was as follows prior to the amendment of Rule 6:

- If goods are sold for delivery at the time and place of removal, and price is the sole consideration for the sale, then the price is the value for assessment to excise duty.
- If the goods are sold for delivery at the time and place of removal, and the buyer has to pay some amounts to the seller or to some other person on behalf of the seller in connection with the sale (for example, handling charges, storage charges, commission, warranty, etc, then all these form part of the transaction value, which is the value for assessment to excise duty;
- If, in addition to the amount payable by the buyer as transaction value, the seller receives a non-monetary consideration from the buyer, the money value of this is added to the transaction value for the purpose of assessment to excise duty.

These were the provisions of law that the Supreme Court considered in deciding the Fiat case. The case concerned a demand of excise duty made because the transaction value was less than the cost of production of the goods.

Fiat India Private Limited were selling motor vehicles at a price that was far below their cost, with the admitted purpose of market penetration. The department's case was that this price could not be 'normal price' as per section 4 of the Central Excise Act, and that the market penetration achieved by the lowered price was a consideration that should be added to the price of the goods. The department demanded differential excise duty of over Rs 300 crores by rejecting the actual selling price of the goods over a period of five years and adopting the cost of production of the vehicles as the assessable value for excise duty. In appeal by the company, the CESTAT rejected this stand of the department quite summarily, by referring to an earlier decision of the Supreme Court in the case of Guru Nanak Refrigeration Corporation. In that case the goods were sold at a launch price that was below the cost of production, in order to maintain parity with other brands in the segment. The Court had observed that an arm's length sale price was available, and in the absence of any flowback this was the normal price for assessement to excise duty.

The department appealed to the Supreme Court against the CESTAT order in the Fiat case. The Supreme Court upheld the department's re-determination of value and the consequential demand of excise duty. In this case of CCE versus Fiat India Private Limited, Civil Appeal Nos. 1648-1649 of 2004, decided on 29-8-2012, reported as 2012 (283) E.L.T. 161 (S.C.), the Supreme Court framed the issue as follows:

1. Whether the Price declared by assessees for their cars which is admittedly below the Cost of manufacture can be regarded as "normal price" for the purpose of excise duty in terms of Section 4(1)(a) of the Act.
2. Whether the sale of Cars by assessees at a price, lower than the cost of manufacture in order to compete and penetrate the market, can be regarded as the "extra commercial consideration" for the sale to their buyers which could be considered as one of the vitiating factors to doubt the normal price of the wholesale trade of the assessees.

The issue of "extra-commercial consideration" was argued by the advocate for Fiat, thus, as recorded in paragraph 52 of the judgment:

> … it is contended by learned senior counsel Shri Vellapally that the reason for the assessees for selling their cars at a lower price than the manufacturing cost was because the assessees had no foothold in the Indian market and, therefore, had to sell at a lower price than the manufacturing cost and profit in order to compete in the market. He would submit that the intention of the assessees to penetrate the market cannot be treated as extra commercial consideration as it does not flow from the buyer to the seller. Therefore, there is no additional consideration flowing from buyer to seller and whole transaction is *bona fide*.

However the Supreme Court proceeded to find that there was an additional consideration in the form of market penetration (- the Court called this "extra-commercial consideration"), in fixing the price at a level

below production cost; and that therefore the department was right in taking the cost of production as the value for assessment. The Court, however, gave no direct finding on the argument reproduced above as extract from paragraph 52 of the judgement, as to whether such consideration flows from the buyer to the seller. In other words, though Rule 6 required that additional consideration (monetary or non-monetary) flowing from the buyer to the seller could alone be added to price to arrive at assessable value, the Supreme Court upheld the adding of a 'consideration' that was undoubtedly a benefit to the seller company but did not flow from the buyer.

The Supreme Court's reasoning was that the consideration that the company received for the transaction was the price as well as the benefit of market penetration and that therefore price was not the sole consideration for the sale; therefore the valuation rules became applicable, and the adjudicating authority was within his rights to use any of the rules or a combination thereof, to arrive at the value for assessment to excise duty. The judgment created consternation in business circles. The spectre of excise duty demands on every loss-making company loomed large over industry. Perhaps as a measure to allay apprehensions, as part of the Budget exercise in July 2014, the central government issued notification 20/2014-CE(NT) to amend Rule 6 of the valuation rules as follows:

2. In the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000(hereinafter referred to as the said rules), in rule 6, before Explanation I, the following proviso shall be inserted, namely:-

" Provided that where price is not the sole consideration for sale of such excisable goods and they are sold by the assessee at a price less than manufacturing cost and profit, and no additional consideration is flowing directly or indirectly from the buyer to such assessee, the value of such goods shall be deemed to be the transaction value." .

The amendment provides that in cases where price is not the sole consideration for sale of the goods, and the goods are sold at a price below manufacturing cost and profit, and no additional consideration flows directly or indirectly from the buyer to the seller, the transaction value is accepted for assessment to excise duty.

The point of doubt now is whether the amendment will provide any relief to loss-making companies, if that was indeed its purpose. Even before amendment of rule 6, additional consideration, if any, was something that flowed from the buyer to the seller. This was the argument taken by counsel for Fiat, as recorded in paragraph 52 of the Fiat judgment of the Supreme Court; he argued that as no additional consideration flowed from the buyer to the seller, there was nothing to add to the actual selling price to arrive at assessable value. Despite this the apex Court has held (in effect) that any additional benefit that the seller gains from the transaction, even if it is not coming from the buyer, is to be added to the price to arrive at assessable value for excise. So, it can be argued that addition of an explicit proviso in which the same rule applies in particular to a loss making transaction, does not really neutralise the effect of the Fiat judgment.

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