

White Paper- EOU: Exemption for DTA Sale of Products Made of Indigenous Material



Ms. Radha Arun, Consultant to Udyog
Software (India) Ltd.

*This document contains a brief on Exemption for DTA Sale of
Products Made of Indigenous Material.*

Udyog Software (India) Ltd.

Hyderabad, Telangana, India
February 17, 2016

EOU: Exemption for DTA Sale of Products Made of Indigenous Material

This paper looks at the chequered history and latest Supreme Court ruling on the exemption for DTA sales of EOUs which is conditional on the product being wholly made of indigenous raw material

Excise duty regimen for DTA sales from EOU

Duty equal to customs duty

A hundred per cent export-oriented unit is allowed to import material and capital goods free of customs duties, as the resultant product is to be exported. But if the resultant product is sold in India, as allowed for some portion of the production, the excise duty on it is statutorily levied at a rate equal to customs duties on the product if it was imported.

Duty on par with DTA units if only indigenous raw material was used

This higher rate of excise duty, at a rate equal to customs duty, does not apply to goods that are produced by the EOU wholly out of indigenous material. Quite clearly, the thinking is that as the product did not benefit from any customs duty exemptions, it is on par with indigenously manufactured goods and can be taxed at the same rate. Therefore, the excise duty levied on goods produced by an EOU out of wholly indigenous material, and cleared to the DTA, is equal to the excise duty on like products manufactured in the DTA. This is achieved by an exemption notification.

Provisions of law

The legal provisions in this regard are as follows.

Section 3

“Provided that the duties of excise which shall be levied and collected on any excisable goods which are produced or manufactured:-

- (i) Omitted
- (ii) by a hundred per cent export-oriented undertaking and brought to any other place in India,

shall be an amount equal to the aggregate of the duties of customs which would be leviable under the Customs Act, 1962 (52 of 1962), or any other law for the time being in force, on like goods produced or manufactured outside India if imported into India, and where the said duties of customs are chargeable by reference to their value, the value of such excisable goods shall, notwithstanding anything contained in any other provision of this Act, be determined in accordance with the provisions of the Customs Act, 1962(52 of 1962) and the Customs Tariff Act, 1975 (51 of 1975).”

Thus, in terms of the first proviso in section 3, duty of excise on goods produced or manufactured in an EOU and brought to any other place in India is levied at a rate equal to the duties of customs that would be levied on like goods if imported.

Notification 8/97-CE

Notification 8/97-CE, which was in effect till 31 March 2003, exempted goods cleared by an EOU to the DTA if they were “produced or manufactured, in a hundred per cent export-oriented undertaking or a free trade zone wholly from the raw materials produced or manufactured in India” and sold in the DTA in terms of the Foreign Trade Policy, from duty of excise in excess of that levied on like goods if produced by a non-EOU.

Notification 23/2003-CE

Notification 8/97-CE was succeeded by notification 23/2003-CE, which, inter alia, at its serial number 3 read with condition 3, provided the same exemption in virtually the same wording. This exemption is extant to date.

Continuous exemption since 1997 for goods made of indigenous raw material

Thus there has been an exemption since 1997 for goods manufactured by an EOU “wholly from raw materials produced or manufactured in India.” Interpretational issues have arisen about what is meant by this expression “produced or manufactured ... wholly from raw materials produced or manufactured in India”.

What is ‘raw material’?

Supreme Court: Ballarpur Industries case: ‘raw material’ does not have to be retained in final product

In the case of CCE v Ballarpur Industries Limited, the Supreme Court examined the meaning of the expression “raw material” in the context of notification 105/82-CE (as it stood at the relevant time), which allowed the benefit of set-off of excise duty paid on raw materials against excise duty payable on the final product. The item in dispute was sodium sulphate used in the manufacture of paper and paperboard. The said item was used in the process of digestion of pulp and was consumed in this process. The contention of Revenue was that it was not found to be retained in the final product and was therefore not to be considered as a raw material for it. However the Court did not accept this argument, and observed that an item was a raw material if it formed a part of the manufacturing process (as distinct from the manufacturing apparatus) and its presence was essential for the emergence of the final product.

The argument that sodium sulphate was not a raw material because it was not found to be retained in the final product was rejected.

Foreign Trade Policy: Definitions of raw material, consumable

The Exim Policy 1997-2002 defined 'consumable' for the first time as distinct from 'raw material'. The definitions were:

' "Consumables" means any item, which participates in or is required for a manufacturing process, but does not necessarily form part of end-product. Items, which are substantially or totally consumed during a manufacturing process, will be deemed to be consumables.' (Para 3.13)

' "Raw material" means:

- (i) basic materials which are needed for the manufacture of goods, but which are still in a raw, natural, unrefined or unmanufactured state; and
- (ii) for a manufacturer, any materials or goods which are required for his manufacturing process, whether they have actually been previously manufactured or are processed or are still in a raw or natural state.' (Para 3.41)

In the present Foreign Trade Policy 2015-20, the definitions are:

"Consumables" means any item, which participates in or is required for a manufacturing process, but does not necessarily form part of end-product. Items, which are substantially or totally consumed during a manufacturing process, will be deemed to be consumables. (Para 9.11)

"Raw material" means input(s) needed for manufacturing of goods. These inputs may either be in a raw/natural/ unrefined/ unmanufactured or manufactured state. (Para 9.44)

It can be seen that the meanings of 'raw material' and 'consumable' have remained constant since 1997.

CBEC circular: imported consumables are not disqualifier for 8/97-CE

In acknowledgment of the difference between raw material and consumable, the CBEI issued a circular 389/22/98-CX dated 5 May 1998, in which it, inter alia, answered a question as to whether 'raw materials' included 'consumables' by clarifying that the notification 8/97-CE does not bar the use of imported consumables. Much of the case law around the exemption for EOUs under notification 8/97-CE and its successor notification 23/2003-CE revolved around this distinction between raw material and consumable.

Karnataka High Court: Gokak Forbes: Wax is a consumable for yarn

The use of imported wax in the process of manufacture of yarn has been the subject matter of much of the litigation around raw material / consumable. The Karnataka High Court in deciding CEA 14 of 2006 filed by Revenue against the decision of the

CESTAT in the case of Gokak Forbes Limited, agreed with the CESTAT that wax was a consumable and that its use would not disentitle the EOU from the benefit of the exemption. Revenue relied on the case of Ballarpur Industries (supra) to no avail.

CESTAT: Super Spinning Mills: Wax is consumable for yarn

Following the Karnataka High Court judgment in Forbes Gokak (supra), the CESTAT held wax to be a consumable in the case of Super Spinning Mills (excise appeal number 909 of 2004) and allowed the exemption. The Supreme Court dismissed Revenue's appeal against this order.

Recent Supreme Court judgment in Meridian Industries is a wake-up call

With these precedents, it seemed a settled position that if the rest of the raw material was indigenous, the use of imported material like wax or sizing material did not act as a disqualification for the exemption, as these material were treated as consumables and not raw material. However a recent Supreme Court judgment about the use of wax in the manufacture of yarn is a wake-up call for those who may have become complacent about the exemption.

Meridian Industries: Wax is a raw material for manufacture of yarn: SC

In the case of Meridian Industries (CA 4112 of 2007, decided on 27 October 2016), the Supreme Court noted that wax is used to lubricate the cotton yarn while winding on cones. It facilitated winding and also settled protruding fibres and thus imparted quality to the yarn. Though washed off completely at the stage of knitting, the wax was on the yarn while it was a yarn. The Court held that the wax was a raw material, and denied the benefit of exemption on this basis.

“The wax coating is found to be essential for lubrication of the yarn and was allowed to remain on the yarn in order to facilitate its winding on cones and its use in knitting hosiery. Wax imparts a quality whereby the protruding fibres of the yarn are made to settle uniformly on the surface of the yarn to enable easy winding. This quality of the yarn is essential for its application in the manufacture of knitted fabrics by the buyers. It follows from the above that insofar as assessee is concerned, it manufactured cotton yarn by applying wax coating thereon. This wax coating, or significant portion thereof, remains on the cotton yarn. The buyer wants wax coating to remain as that is needed for lubrication of the yarn to facilitate its winding on cones when the buyer uses the said cotton yarn for manufacture of hosiery. No doubt that cotton yarn can be produced without wax as well. However, such cotton yarn without wax would be of inferior quality for the purposes of buyer in comparison with cotton yarn coated with wax as the use of cotton yarn with wax thereupon acting as lubricant is much more useful and becomes a value addition making it better quality cotton yarn, insofar as requirement of the buyer in using such cotton yarn for manufacture of knitted fabrics is concerned. When matter is examined from this angle, an irresistible conclusion is arrived at, namely, wax was used as raw material and not as consumable, insofar as end product of the assessee is concerned.” (para 21)

With this judgment of the Supreme Court now holding the field, the factual determination of what is a raw material and what is a consumable has to be done with extreme care for the purposes of exemption under notification 23/2003-CE.

Please connect with us at:

Web: www.udyogsoftware.com

Email: teammarketing@udyogsoftware.com