IN THE CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL SOUTH ZONAL BENCH, CHENNAI

C/318/2007

(Arising out of Order-in-Appeal C. Cus. No.278/2007 dated 21.5.2007 passed by the Commissioner of Customs (Appeals), Chennai – I)

Commissioner of Customs (Sea), Chennai Appellant

Vs.

M/s. Remy Electricals India Ltd. Respondent

Appearance

Shri B. Balamurugan, AC (AR) for the Appellant
Shri S. Murugappan, Advocate for the Respondent

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Hon'ble Ms. Sulekha Beevi C.S., Member (Judicial)
Hon'ble Shri Madhu Mohan Damodhar, Member (Technical)

Date of Hearing / Decision: **08.05.2017**

Final Order No. 40682/2017

Per Madhu Mohan Damodhar

The respondent importer had imported auto parts from M/s. Telco America, USA. Issue in dispute relates to addition to assessable value of technical know-how fees of Rs.99,99,999/- and running royalty. The original authority, in denovo adjudication, while accepting the invoice value of the imports for assessment purpose in terms of Rule 4(3)(a) of Customs

Valuation Rules, 1988, however, ordered that technical know-how fees and royalty shall be added to invoice value in terms of Rule 9(1)(c) of the said Rules. The importers preferred an appeal before learned Commissioner (Appeals). Vide impugned order dated 21.5.2007, the Commissioner (Appeals) set aside that portion of the order of the original authority with regard to addition of technical know-how and royalty fees to assessable value.

2. Aggrieved against the order of the Commissioner (Appeals), the department has filed this appeal.

3. Today, when the matter came up for hearing, learned AR reiterated the grounds of appeal. He took us to Rule 9(1)(c) of the Rules to contend that royalty and license fees related to the imported goods that the buyer is required to do, whether directly or indirectly, as a condition of sale of the goods being valued will required to be added to the assessable value. Learned AR submits that payment of know-how fees as well as royalty is very much a condition for sale of the goods imported. In the instant case, payment of royalty and license fee as defined under Rule 9(1)(c) are related to the imported goods and hence will require to form part of the assessable value for the purpose of discharging customs duty liability.

4. On the other hand, learned counsel Shri S. Murugappan for the respondent, contends that there is no condition of sale

attached to the import of the goods. He submits that the technical know-how fees are related to manufacturing know-how, hence related to product that would be manufactured out of the goods imported. As such, the technical know-how fees cannot be made an accretion to the value of the imported goods. Similarly, in respect of royalty, they are directly related to the sale of the goods manufactured and hence cannot form part of the assessable value at the time of import. He places reliance on the ratio of the judgment of the Hon'ble Supreme Court in the case of Commissioner of Customs Vs. Ferodo India Pvt. Ltd. - 2008 (224) ELT 23 (SC).

5. Heard both sides and have gone through the facts.

6. The license agreement available in the appeal folder has been perused by us. Para 2 of the license agreement concerns technical know-how granted to appellants to exclusively manufacture, market, sale and distribute the licensed products within the territory agreed upon. Para 4 of the agreement specifies that for grant of such technical know-how license of technical know-how, the following amounts have to be paid:-

(a) Technical know-how license fee of Rs.99,99,999/-; and

(b) Running royalty on **sales** of each licensed product at specified rates, initially 5% and subsequently at 3% on net ex-factory price of these products.

7. We are, however, unable to find out any condition precedent in the license agreement which ties the import of the impugned goods to the payment of the technical know-how and license fees. The imports are therefore definitely not conditional to payment by importer of additional technical know-how fees or royalty. There is no inseparable umbilical cord linking the impugned imports and the technical know-how/royalty fees. On the other hand, what we find is that these fees are directly, conspicuously and separately relatable to the manufacture and sale of products under license. It is also not the case of the department that capital goods or machinery for manufacture of the license product are involved in the current import. There is no dispute that the goods imported are nothing but automotive components.

8. Commissioner (Appeals) in the impugned order, has analysed these aspects in detail and has found that in the agreement, net ex-factory price categorically excludes the cost of the imported components and hence ingredients of Rule 9(1)(c) that it should be relatable to imported goods and should be condition of sale are not satisfied. Addition of royalty cannot then be made on the value of these imported goods. Thus, in our opinion, is the correct interpretation of the facts of the case.

9. In the judgment of the Hon'ble Supreme Court in the case of Ferodo India Pvt. Ltd. (supra), identical issue was under consideration before the Apex Court and it was held that royalty / license fee shall not be a condition prerequisite to the sale of the imported goods and hence not includible in the assessable value thereof. The following paragraphs of the said judgment make for illuminating reading:-

> *"18. Royalties and licence fees related to the imported goods is the cost which is incurred by the buyer in addition to the price which the buyer has to pay as consideration for the purchase of the imported goods. In other words, in addition to the price for the imported goods the buyer incurs costs on account of royalty and licence fee which the buyer pays to the foreign supplier for using information, patent, trade mark and know-how in the manufacture of the licensed product in India. Therefore, there are two concepts which operate simultaneously, namely, price for the imported goods and the royalties/licence fees which are also paid to the foreign supplier. Rule 9(1)(c) stipulates that payments made towards technical know-how must be a condition pre-requisite for the supply of imported goods by the foreign supplier and if such condition exists then such royalties and fees have to be included in the price of the imported goods. Under Rule 9(1)(c) the cost of technical know-how is included if the same is to be paid, directly or indirectly, as a condition of the sale of imported goods. At this stage, we would like to emphasis the word indirectly in Rule 9(1)(c). As stated above, the buyer/importer makes payment of the price of the imported goods. He also incurs the cost of technical know-how. Therefore, the Department in every case is not only required to look at TAA, it is also required to look at the pricing arrangement/agreement between the buyer and his foreign collaborator. For example if on examination of the pricing*

arrangement in juxtaposition with the TAA, the Department finds that the importer/buyer has misled the Department by adjusting the price of the imported item in guise of increased royalty/licence fees then the adjudicating authority would be right in including the cost of royalty/licence fees payment in the price of the imported goods. In such cases the principle of attribution of royalty/licence fees to the price of imported goods would apply. This is because every importer/buyer is obliged to pay not only the price for the imported goods but he also incurs the cost of technical know-how which is paid to the foreign supplier. Therefore, such adjustments would certainly attract Rule 9(l))(c).

Application of Rule 9(l)(c) to the facts of the present case

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22. In the case of Essar Gujarat Ltd. (supra), the buyer had entered into a contract with TIL for purchase of Direct Reduction Iron Plant ("the plant"). The entire agreement was for import of the plant. The agreement was subject to two conditions- (a) approval of G.O.I. and (b) obtaining transfer of licence from M/s. Midrex, USA. Without the licence from Midrex, the imported plant was of no use to the buyer. Therefore, it was essential to have the licence from Midrex to operate the plant. Therefore, it was held by this Court that procurement of licence from Midrex was a pre-condition of sale which was specifically recorded in the agreement itself. In view of specific terms and conditions to that effect in the agreement, this Court held that payments made to Midrex by way of licence fees had to be added to the price paid to TIL for purchase of the plant. There is no such stipulations in the TAA in the present case. Therefore, in our view, the adjudicating authority erred in placing reliance on the judgment of this Court in Essar Gujarat Ltd. (supra).

23. In the case of Matsushita Television & Audio India Ltd. v. CoC reported in 2007 (211) E.L.T. 200 (S.C.) the question which arose for determination was whether royalty amount was

Customs, Excise & Service Tax Appellate Tribunal *attributable to the price of the imported goods. In that case, the appellant was a joint venture company of MEI, Japan and SIL for obtaining technical assistance and know-how. Under the agreement, the appellants were to pay MEI a royalty @ 3% on net ex-factory sale price of the colour TV receivers manufactured by the appellants for the technical assistance rendered by MEI. The appellants were to pay a lump-sum amount of U.S. $ 2 lakhs to MEI for transfer of technical know-how. It was the case of the appellant that payment of royalty was not related to imported goods as the said payment was made for supply of technical assistance and not as a condition pre-requisite for the sale of the components.*

24. One of the questions which arises for determination in this civil appeal is whether reliance could be placed by the Department only on the Consideration Clause in the TAA for arriving at the conclusion that payment for royalty was includible in the price of the important components.

25. Rule 4(3)(b) of the CVR, 1988 provides for an opportunity for the importer to demonstrate that the transaction value closely approximates to a "test" value. A number of factors, therefore, have to be taken into consideration in determining whether one value "closely approximates" to another value. These factors include the nature of the imported goods, the nature of the industry itself, the difference in values etc. As stated above, Rule 4(3)(a) and Rule 4(3)(b) of the CVR, 1988 provides for different means of establishing the acceptability of a transaction value. In the case of Matsushita Television (supra) the pricing arrangement was not produced before the Department. In our view, the Consideration Clause in such circumstances is of relevance. As stated above, pricing arrangement and TAA are both to be seen by the Department. As stated above, in a given case, if the Consideration Clause indicates that the importer/buyer had adjusted the price of the imported goods in guise of enhanced royalty or if the Department finds that the buyer had misled the Department by *such pricing adjustments then the adjudicating authority would be justified in adding the royalty/licence fees payment to the price of the imported goods. Therefore, it cannot be said that the Consideration Clause in TAA is not relevant. Ultimately, the test of close approximation of values require all circumstances to be taken into account. It is keeping in mind the Consideration Clause along with other surrounding circumstances that the Tribunal in the case of Matsushita Television (supra) had taken the view that royalty payment had to be added to the price of the imported goods."*

10. In view of the aforesaid discussions and respectfully following the ratio laid down by the Hon'ble Apex Court in the case of Ferodo India (supra), we do not find any infirmity in the impugned order passed by Commissioner (Appeals) and consequently the appeal of the department will require to be dismissed, which we hereby do. The appeal is dismissed.

(Dictated and pronounced in open court)

(MADHU MOHAN DAMODHAR)	**(Ms.SULEKHA BEEVI C.S.)**
Member (Technical)	Member (Judicial)

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Customs, Excise & Service Tax Appellate Tribunal

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