CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
CHENNAI

REGIONAL BENCH - COURT No. III

Excise Appeal No.41008 of 2015

(Arising out of Order-in-Original No.05/2015 dt. 29/01/2015 passed by Commissioner of Central Excise, Chennai – I Commissionerate, No.26/1, Mahatma Gandhi Marg, Nungambakkam, Chennai 600 034)

M/s.ITC Limited **.... Appellant**
SBU_Packaging and Printing
Post Box No.2277
Tiruvottiyur,
Chennai 600 019.

VERSUS

The Commissioner of CGST & Central Excise **... Respondent**
Chennai North Commissionerate
No.26/1, Mahatma Gandhi Road,
Nungambakkam,
Chennai 600 034.

APPEARANCE :

Ms. L. Maithili, Advocate, for the Appellant
Shri R. Rajaraman, Authorised Representative for the Respondent

CORAM :

HON'BLE MS. SULEKHA BEEVI.C.S., MEMBER (JUDICIAL)
HON'BLE MR. VASA SESHAGIRI RAO, MEMBER (TECHNICAL)

FINAL ORDER No.40622/2024

DATE OF HEARING : 03.06.2024
DATE OF DECISION : 03.06.2024

Per: Ms. Sulekha Beevi. C.S

Brief facts are that the appellant is engaged in manufacture of printed packaging materials and are registered with the Central Excise Department. During the scrutiny of books of accounts / trial balance for the period 2007-08 to 2011-12 upto March 2012, the officers of the Audit noticed that the appellant has written off finished goods to the tune of Rs.3,79,21,716/- during the above period. On query raised by audit team, the appellant replied that the said finished goods were not cleared and written off due to quality issues, design change by customer, ageing of the finished goods etc. They also informed that the said goods were disposed off as waste and shown under waste account in the monthly in ER-1 Returns as Waste & Scrap of paper & Paper Boards under Chapter 47 of the Central Excise Tariff Act, 1985.

2. It appeared to the department that the appellant has not accounted for entire finished goods correctly in their Daily Stock Account to be maintained under Rule 10 of Central Excise Rules, 2002 and had cleared finished goods in the guise of waste and scrap and reflected it deliberately in the ER-2 returns under the heading Waste and Scrap of paper and Paper Board. The department was of the view that the value of goods cleared has not been assessed to duty as per Rule 6 of Central Excise Rules, 2002 and were not properly accounted as per Rule 10 of the CER 2002. Show cause notice was issued to the appellant proposing to demand Central Excise duty along with interest on the amount reflected as "*written off finished goods in the trial balance*'. After due process of law, the original authority confirmed the demand, interest and imposed penalties. Aggrieved by such order, the appellant is now before the Tribunal.

3. The Ld. Counsel Ms. L. Maithili appeared and argued for the appellant. Ld. Counsel made the following submissions :

3.1 The Appellant manufactures packaging materials on the basis of orders given by various buyers from time to time. The goods, namely packaging materials with the design, colour scheme, logo etc. are manufactured as per customer specifications. The Appellant has to ensure that the final products strictly meet the quality parameters, including artwork, colour scheme etc. specified by the customers. The last step in the manufacturing process involves quality inspection where the printed packaging material are closely examined to ascertain whether they meet all the customer specifications on design, colour, creases etc. Sometimes, there could be a sudden change in design by the customer. Only those packaging material which meet all the customer requirements are treatable as manufactured final products cleared on payment of appropriate Central Excise duty. Those final products which cannot be supplied to the customer on account of being defective or not meeting the customer requirements, have to be necessarily scrapped as waste. The packaging material so scrapped is collected in the scrap godown for disposal and are removed from the factory on payment of excise duty at the prescribed rate applicable to waste and scrap of paper and paperboard on the transaction value. The **details of clearance of such waste and scrap of paper and paper board are duly reflected in the ER-1 Returns filed by the Appellant periodically. (Annexure A of reply to SCN).** In keeping with the standard accounting practice, a provision is made for write-off of the total quantity of rejected finished goods at the end of every quarter in the Trial Balance. After obtaining internal approvals, the actual write-off is effected.

3.2 In March 2008 CERA Audit was conducted and certain clarifications were sought. By letter bearing O.C. No. 208 /2008 dated 13.10.2008, the range Officer raised specific queries and the Appellant was asked to provide certain further details, inter alia with regard to entries in the Trial Balance 2007-08. The Appellant gave a detailed reply dated 29.10.2008. Further specific queries were raised over telephone in August 2013 to which the Appellant replied by letter dated 04.09.2013. Additional queries were then raised, which were duly replied to by letter dated 17.10.2013.

3.3 The allegations made against the appellant in SCN No.15/2013 dated 29.10.2013 during the period 2007-08 to 2011-12 are as under :

- As per the Trial Balance for 2007-08 to 2011-12 (Upto March 2012) the Appellant has written off finished goods valued at Rs. 3,79,21,716/-;
- Contravention of Rule 6 and rule 10 by not correctly accounting for the finished goods in the Daily Stock Account;
- Not produced evidence of having shown such clearance in the Daily stock account and in the ER-1 returns;
- Clearance of finished goods as waste, without payment of appropriate duty;
- The fact of clearance of written-off finished goods came to light during scrutiny of books of Account by the Audit team;
- Suppression of fact of write-off of finished goods and clearance of goods as waste with intent to evade payment of duty.

3.4 The appellant filed a detailed reply to the show cause notice dated 29.04.2014 as under :

- No demand can be made based merely on book entries;
- Demand not being made on actual clearances is without jurisdiction;
- Without physical verification of actual clearance of waste and scrap, no room for alleging clearance of Finished Goods as waste;
- Such an allegation contradicts the admitted fact that provision for write-off was made on account of defects in quality making the goods incapable of being marketed as packaging materials to the customers;
- There is a deliberate omission on the SCN that the waste and scrap of paper was cleared on payment of duty;
- There is no contravention of Rule 10, as the finished goods found defective cannot be treated as a fully manufactured

product, as it is not marketable as such and hence cannot be entered in the Daily Stock Account. Such material is thus written-off and details of the same is duly recorded in the register maintained for waste. The details of the final products found fit for clearance to the customer, after inspection, are duly entered in the Daily Stock Register.

- There is no contravention of Rule 6, as all goods have been cleared after due assessment and on payment of appropriate duty.
- The value adopted for write-off made in the Trial Balance is irrelevant and cannot form the basis for valuation under the Central Excise Act, wherein valuation adopted must be as prescribed U/s.4 read with the Valuation Rules,2000.
- Waste and scrap having been cleared on payment of appropriate duty, there is no scope for demanding duty once again on the same, without questioning their classification or valuation and without taking into account the duty already paid.
- The extended period of limitation cannot be invoked, as all facts were known to the department since March 2008 and the allegations in the SCN have been made from books of account available for scrutiny all along.

3.5 It is submitted by the learned counsel that there is no contravention of Rules 6 & 10 of CER 2002. The appellant has established with evidence that the production of the final product as also waste products has been duly recorded in ER.1 as well as waste register on a daily basis. The value reflected in the trial balance as "finished goods written off" are goods which have not reached the final stage or rejected during the quality check as well as rejected and returned by the customer. These are only waste products and not fit for clearance as finished products. The appellant is therefore not liable to pay duty under the Central Excise Act, 1944 as if final products to this quantity are cleared by the appellant. There can be no demand of duty based merely on accounting / book entries. The demand has been confirmed merely on the basis of provision to write-off in the trial balance of the company and not on actual removal of finished products.

3.6 It is submitted that there is no allegation of clandestine removal also. The impugned order is passed on assumptions and presumptions. Without an iota of evidence, the department has presumed that the goods in question were fit for sale though were lying in storage for a long time.

3.7 It is an admitted position in the SCN that write-off of the finished goods is made by appellant only due to quality issues, design change by customer, aging of the finished goods etc. The department has failed to appreciate that the goods which do not pass the quality control are nothing but waste paper / paper board unfit for use / sale as packaging material and hence have to be necessarily scrapped.

3.8 The SCN is issued invoking the extended period. The appellant has not suppressed facts with intent to evade payment of excise duty. The entire details were taken by the department from the accounts maintained by the appellant. Further, the issue has arisen pursuant to CERA Audit conducted in March 2008. Ld. Counsel adverted to the letter dt. 13.08.2010 issued by the department enquiring with regard to the amount shown in their trial balance as finished goods written off. The appellant immediately replied on 29.10.2008 itself explaining as to why they have shown the amount as 'written off'. Further, the show cause notice was issued only on 29.10.2013 alleging suppression of facts invoking the extended period. It is submitted that the appellant has not suppressed any facts and having replied to the query raised by the Audit Committee, the invocation of extended period alleging suppression of facts cannot sustain.

3.9 Ld. Counsel adverted to paras 7.3 & 7.4 of the impugned order to argue that even according to the department, it is not stated that appellant has cleared finished goods. Therefore the demand of excise duty cannot sustain. It is prayed that the appeal may be allowed.

4. Ld. A.R Shri R. Rajaraman appeared and argued for the Department. It is submitted that in para 7.3 & 7.4 the adjudicating authority has stated that the goods have undergone the process of manufacture and even as per the Trial Balance, it is stated that these are finished goods. The goods have been manufactured by the appellant and also having attained the characteristics of finished goods. The appellant is therefore liable to pay excise duty on the same. The goods are accounted in their trial balance as 'written off' and has thus escaped payment of excise duty. The appellant ought to have accounted such manufactured goods in their daily stock register as well as ER-1 register and discharged excise duty. Thus appellant suppressed the facts with intent to evade payment of excise duty and therefore the show cause noticed issued invoking the extended period is legal and proper. It is prayed that the appeal may be dismissed.

5. Heard both sides.

6. The issue to be considered is whether the demand raised alleging suppression of facts with intent to evade payment of excise duty on the value of goods accounted as 'written off' is sustainable or not.

6.1 The allegation of the department is that the appellant has accounted the finished goods in their trial balance to the tune of Rs.3,79,21,716/- as 'written off' and that these being final products, the appellant ought to have paid excise duty. On perusal of the show cause notice the department itself is of the view that these finished goods are not fit for sale to customers and are rejected / waste arising in the process of manufacture. Paras 7.3 & 7.4 of the impugned order make this very clear which reads as under :

> "7.3 So far as the first issue is concerned, I find that the goods were found to be defective only after the complete manufacturing process was Over. From the e-mail submitted by the assessee, as well as the samples which were shown during the course of personal hearing, it is seen that the goods have achieved the essential characteristics of finished goods. In fact, in the mail dated 24-06-2014, the customer has informed that "we came across a serious quality fault in London blanks and outers.... and the issue was a significant white dot on the blanks and outers". From the above communication, it is clear that the goods under consideration in the SCN have achieved the stage of being finished goods and the defect has only

> been detected at the time of quality check or, in some cases, even after clearance of a part of finished goods to the customers.
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> 7.4 This communication essentially answers the question whether the goods have achieved the stage of being entered into the RG1 register as finished goods or not. Once the goods have achieved the characteristics where they are, ready to be cleared to the customers, then it cannot be said that the goods have not achieved the characteristics of finished goods. Further, M/s.ITC have, in their written submissions and at the time of personal hearing, have themselves admitted that some of the goods cleared as waste and scrap were not usable, or marketable, due to factors like (i) Ageing or (ii) change of design. I am unable to understand how the goods which were fit for sale to the buyer but could not be cleared to them due to long storage of the goods or change in design by the buyer cannot be called finished goods. This clearly shown that there was a deliberate intent by M/s.ITC not to account for certain finished goods in their daily stock register for considerable period of time."

6.2 From the above discussion in the impugned order, it can be seen that to demand duty the department has taken the view that since the goods (though rejects) have undergone the process of manufacture the appellant is liable to pay excise duty since the goods have all the characteristics of final product. We are unable to agree with this view of the department. When the goods are rejects and not fit for sale by the appellant, the incidence of duty is not attracted. The appellant has explained that these are goods which are rejects and also goods which have been returned by the customer due to defects. Such defective and rejected goods have been cleared by the appellant as waste and they have also discharged duty on such waste. They have accounted for such waste and also for the duty paid on such waste. The Department has not conducted any investigation with regard to the defence put forward by the appellant that they have been clearing rejected goods as waste and have been paying duty on the same. So also, no reconciliation is done by the department with regard to the value that has been shown in their ER-1 returns as 'waste'. The finding of the original authority that, since goods have undergone the complete process of manufacture and also mentioned in the trial balance as *"finished goods"*, the appellant has to discharge excise duty on such value, cannot be accepted. It has to be proved that the appellant has manufactured and sold finished goods. The incidence of duty is not attracted on finished goods manufactured and not sold.

Further the figures have been taken from the accounts / trial balance of the appellant. In such circumstances, there is no suppression of facts. The appellant has replied immediately to the query raised in consequence of CERA audit. They have explained in 2008 itself that the finished goods are nothing but rejects/defects. The department has slept over the reply given by appellant and issued the SCN only in 2013 alleging suppression of facts and invoking the extended period. There is no positive act of suppression established against the appellant. There is no evidence that the finished goods accounted were sold by appellant and that they received sale consideration.

6.3 There are no grounds for invoking the extended period. Even on merits, we do not find a fit case for raising the demand of duty. In view thereof, the impugned order is set aside on the ground of limitation. The appellant succeeds on the ground of limitation.

7. Appeal is allowed with consequential reliefs, if any.

(Order dictated and pronounced in the open court)

sd/-
(VASA SESHAGIRI RAO)
Member (Technical)

sd/-
(SULEKHA BEEVI. C.S)
Member (Judicial)

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