CUSTOMS EXCISE & SERVICE TAX APPELLATE TRIBUNAL,
West Block No.2, R.K.Puram, New Delhi

COURT-I

Date of hearing: 07.08.2017
Date of decision: 14.08.2017

Appeal No. C/52951 Of 2016
(With C/52949/2016 & 52950/2016)-CU[DB]

[Arising out of the Final Order No. 01/NKU (01) ADJ/ DRI/ N. DELHI/ 2016-17 dated 28/04/2016 Passed by Additional Director General (Adjudication), New Delhi]

Ericsson (i) Pvt. Ltd. & Others … Appellant

Vs.

CCE Delhi … Respondent

Appearance:
Present Shri V.Lakshmikumarn, Advocate for the appellant
Present Shri Govind Dixit, DR for the respondent

Coram: Hon'ble Justice Dr. Satish Chandra, President
Hon'ble Mr. V. Padmanabhan, Member (Technical)

FINAL ORDER No. 55841-55843/2017

Per: V. Padmanabhan

1. These three appeals are filed by M/s Ericson Pvt. Ltd and Shri Bharat Bandhu, Head of Company Control Hub, as well as Shri Tej Nirmal Singh, Director & Head of Supply. All the appeals are against Order in Original NO. 1/2016-17 dated 04/08/2016. The impugned order it was held as follows:

i. The differential Customs Duty demanding Rs. 19,03,87,636/- along with penalty under Section 114 A of the Customs Act of the amount equal to the customs duty demanded above.

ii. Demand of interest also confirmed under Section 28 AB/ Section 28 AA.

iii. Penalty imposed on Shri Bharat Bandhu is Rs. 1,86,00,000/- under Section 112. Then penalty imposed on Tej Nirmal Singh is Rs. 1,86,00,000/-.

2. Aggrieved by the impugned order the present appeals have been filed which are being decided through this common order.
3. With the above background we heard Shri V. Lakshmikumaran, Senior Advocate on behalf of all the appellants and Shri Govind Dixit, Ld. DR on behalf of the Revenue.
4. The appellant Company is a wholly owned subsidiary of M/s Telefonaktiebolaget LM Ericsson, Sweden (hereinafter referred to as "LME"). LME is also the ultimate holding company of all Ericson group companies. The Appellant has a factory in Jaipur, Rajasthan for manufacture and supply of telecommunication equipment to various telecom service providers. The present appeal centers around whether royalty paid by the Appellant to LME for grant of access to proprietary Ericsson knowhow and Ericson IPR for undertaking the manufacture/ assembly of Radio Base Station ('RBS'), Mobile Switching Centers ('MSC') and Base Station Controllers ('BSC') used in GSM (Global System for Mobile communication) networks is includible in the value of components imported from Ericsson AB, Sweden (hereinafter referred to as "EAB").
5. The appellant have entered into contracts with other group companies as follows:
    i. Supply Contract dated 18.02.2011 with Ericsson AB, Sweden (EAB): The Appellant has entered into the supply contact from time to time (last contract dated 18.02.2011) with EAB for supply of components for manufacture of GSM based cellular mobile equipment like Digital Truck Exchange/Axe Switches/Radio Base Stations/ Minilinks etc. Under the contract, components are to be supplied in

accordance with the agreed terms and conditions and as per the price list appended to the contract.

ii. Technical co-operation agreement dated 23.12.2008 with LME, Sweden: The Appellant (licensee' under the agreement dated 23.12.2008 (hereinafter referred to as 'license agreement' or 'TCA') with the parent company LME, Sweden ('licensor' under the agreement) for grant of non-exclusive rights and licenses to manufacture, sell, repair, and service Licensed Products (RBS, MSC,BSC and other products to be agreed) using Ericsson knowhow and Ericson IPR furnished by the Licensor.

iii. On the basis of the supply contract with EAB, appellant imported various components from time to time. The Ld. Senior Counsel for the appellants submits that such import from related supplier has been examined by the Special Valuation Brach from time to time and the valuation has been accepted. SVB specially has passed orders accepting transaction values in 2007, 2010 and 2013. As per the technical cooperative agreement, TCA, the appellant was provided access to Ericson knowhow and IPR, which was made used by the appellant for purpose of manufacture of the licensed products in their factory.

iv. In addition to the imported components, the appellant also procured components logically for use in the manufacture of licensed products. Some imports have also been made from other third party suppliers. In terms of the TCA, the appellant have been paying royalty to LME, w.e.f 01/04/2008. The royalty fee for the period up to

01/04/2008 was waived by LME. As per the Article 4.1 of TCA, royalty at the rate of 5 per cent of the total net selling price of licensed products, sold by the appellant was being paid. Such net selling price was to be calculated as gross selling price minus excise duty as well as other taxes and cost of imported components used in the manufacture of licensed products. The TCA dated 23/12/2008 was in operation until 31/03/2012. Even though royalty was being paid at the rate of 5 per cent, the customs department did not propose to load the value of components imported from EAB with such royalty. The situation changed with the execution of new technical cooperation agreement dated 27/06/2013 with LME, Sweden which was made effective from 01/04/2012. As per the new agreement royalty was paid at the rate of 5.7 per cent of the gross sale price of the licensed products. Such gross sales price was to be calculated as local sale value minus the excise duty as well as other taxes; on the manufacture and sale of licensed products. The significant difference between this TCA and the earlier one was the cost of imported components was to be included in the sale price for payment of royalty at the rate of 5.75 per cent. The appellant paid royalty for the years 2012-2013, 2013-2014. The present dispute is regarding the includability of the royalty paid for these two years on the value of components imported from EAB under rule 10(1) of the Customs Valuation Rules, 2007.

6. Directorate of Revenue Intelligence carried out investigations into the affairs of the appellant and on conclusion of such

investigation issued show cause notice dated 03/08/2015 in which it was alleged that the appellant had conspired to miss declare the value of imported goods to avoid payment of duty. Notice proposed to add the royalty amount paid to LME, Sweden to the value of components imported from EAB under the supply contract. After the due process of adjudication, the impugned order came to be passed in which payment of differential duty by including the value of royalty in the assessable value of the imported components was ordered in terms of Rule 10 (1) (c) of the Customs Valuation Rules, 2007.

7. Shri V. Lakshmikumaran, Senior Counsel, arguing the case of the appellant, submits the following main points.

   i. In terms of Rule 10 (1) (c), royalties may be added to the price of imported goods only if such royalties are related to the imported goods that the buyer is required to pay directly or indirectly, as a condition of the sale of goods being valued, to the extent that such royalties are not included in the price actually paid or payable. He argued that the royalties were being paid to LME, Sweden strictly for the purpose of the appellant getting access to Ericson knowhow as well as IPR which are required for the purpose of undertaking manufacture of the licensed products in their Jaipur factory. He further submitted that the license agreement was only for the purpose of availing the service on which service tax was being paid in the category of royalty service. Since such royalties are not being paid as a condition of the sale of goods by EAB, there is no justification for loading such value into the price of imported components. He also added that service tax and customs duty cannot be demanded on the same transaction as the two are mutually exclusive. He also added that the royalty is a percentage of sales value of products manufactured in India and the same has no nexus with the imported components.

ii. Since the value of goods imported by the appellant from the related supplier EAB has been repeatedly investigated by the Special Valuation Branch, there can be no allegation of suppression against the appellant. He also relied upon several case laws including **CC v/s Ferodo India Pvt. Ltd.** 2008 (224) ELT 23 (SC), **Sandvik Asia Pvt. Ltd. V/s CC (Import), Mumbai** 2015 (329) ELT 493 (Tri.-Mum) and **BASF India Pvt. Ltd. V/s CC (Import),Mumbai** 2014 (314) ELT 462 (Tri-Mum)

8. The Ld. Counsel also submitted that the facts of the present case were almost identical to the case of Ferodo India decided by the Hon'ble Supreme Court. Accordingly, he submitted that the appeals may be allowed.

9. The Ld. DR supported the impugned order. He argued that even though there are separate agreements with LME for supply of knowhow as well as with EAB for supply of components,it is to be noted that all three parties are related to one another in as much as both the appellant as well as EAB are subsidiaries of LME, Sweden.

10. The Ld. DR referred to various case laws which have been discussed by the Adjudicating Authority for confirmation of duty demand. In particular he emphasized the following case laws.

1. Matsushita Television & Audio (I) Limited v/s Commissioner of Customs [2007 (211) ELT 200 (SC)].
2. Agro Tech Foods P. Ltd. Vs Commissioner of Customs (I), Nhavasheva, 2015 (330) ELT 448 (Tri-Mum.)
3. Commissioner of Customs, Mumbai v/s Clariant (India) Ltd. 2007 ELT 481 (SC).

The Ld. DR further submitted that the Tribunal in the case of Agro Tech foods supra has distinguished the decision of the Hon'ble Supreme Court in the Ferodo India case. Finally, Ld. DR submitted that the impugned order needs no modification.

11. We have heard both sides and perused the appeal records. The appellant has entered into license agreement with LME Sweden for transfer of technical knowhow and IPR they have also entered into separate contract with EAB, Sweden for supply of components. Royalty, which is the subject matter of the present dispute, is being paid by the appellant to LME, Sweden persu to the license agreement. The case of the revenue is that such royalty payment needs to be added to the value of components imported by the appellant as per the supply contract of EAB.

12. It is relevant to note that in terms of the erstwhile license agreement dated 23/12/2008, royalty was to be paid at the rate of 5 per cent of the set selling price of the licensed products, from which cost of imported components were to be excluded along with taxes. However, in the new license agreement w.e.f. 01/04/2012 the royalty amount of 5.75 per cent was to be paid on the sale value of the licensed products after exclusion of

taxes but including the cost of the imported components. Since the significant percentage of the imported components have been procured from EAB Sweden, revenue has taken the stand that such royalty is to be considered as the condition of sale of the components by EAB to the appellant.

4. From the impugned order we find that the show cause notice as well as impugned order has relied upon the judgment of the Hon'ble Supreme Court in Matsushita Television & Audio (I) Limited v/s Commissioner of Customs (supra) in which the Apex Court held as follows:-

> **7.** The question which arises for consideration in this civil appeal is : whether royalty payment was connected with the imported components. Under Rule 9(1)(c) of the Valuation Rules, 1988, only such royalty which is relatable to the imported goods and which is a condition of sale of such goods alone could be added to the declared price. However, in the present case, payment of continuing royalty was payable at the rate of 3% of the net ex-factory sale price of the colour T.V. exclusive of taxes, freight and insurance *but including the cost of imported components.* In other words, the royalty payment was to be computed not only on the domestic element of the net sale price of the colour T.V. but also on the cost of imported components. A bare reading of the agreement shows that payment under the said agreement related not only to the production of the goods in India but also to imports. In some of the decisions cited on behalf of the assessee, we find that the net ex-factory sale price of the finished products expressly excluded the cost of imported components. On the other hand, in the present case, the cost of imported components was expressly included in the net ex-factory sale price of the colour T.V. Further, when payment to MEI was at the rate of 3% of the sales turn over of the final product, including cost of imported component, it became a condition of sale of the finished goods. Hence, in this case both the conditions of Rule 9(1)(c) of the Valuation Rules, 1988, are satisfied

It is to be noted that facts of case before the Apex Court was similar to the present case. Accordingly, revenue has taken the view that royalty is to be added.

13. The appellants have relied on the subsequent Apex Court decision in the case of Ferodo India (supra). It has been argued that the facts before the Apex Court in Ferodo was similar to the

present case and the decision is in their favour. The facts of the Ferodo India case are as follows:

> "3. The buyer is the manufacturer of brake liners and brake pads in India. On 8-9-1995, a technical assistance and trade mark agreement ("TAA" for short) was entered into between the respondent (buyer/licensee) and M/s. T & N International Ltd., U.K. (foreign collaborator/licensor). Under the said agreement, the licensor claimed to be in possession of certain secret processes, formula and information. Under the agreement, the licensor agreed to permit manufacture of brake liners and brake pads (licensed products) by the licensee. Under the agreement, the licensor agreed to disclose the relevant secret processes, formula and information to the licensee. Under the agreement, the licensee was required to import/buy raw material and capital goods from the licensor. Under the agreement, the licensee was obliged to pay a licence fee along with royalty, based on the net sales value of licensed products sold, consumed or otherwise disposed of."

The Apex Court further observed as follows:

> "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)."

The Apex Court further observes as follows :

> **"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.
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> **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."

14. What merges upon carefully consideration of the decisions of the Apex Court in Ferodo as well as Matsushita TV cases (supra) is that before adding the royalty amounts to the value of imported components, it is necessary for the department to examine both the technical assistance agreement as well as the pricing agreement. Before taking the final view in the matter, it is necessary to reexamine the matter of both license agreement as well as supply contract simultaneously, as has been observed by the Apex Court in the Ferodo India case, to see if the enhanced royalty was in the guise of adjustment of the price of components. To facilitate such reconsideration, we set aside the

impugned order and remand the matter to the Adjudicating Authority.

15. Needless to mention that adequate opportunities of effective hearing should be provided to all the appellants before passing de novo decision in the matter.

[Order Pronounced in the open court on _14/08/2017]

(Justice Dr. Satish Chandra)
President

(V. Padmanabhan)
Member (Technical)

Rekha