IN THE CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
WEST ZONAL BENCH AT MUMBAI
COURT NO. II

Appeal No. E/921/2007 & E/403/2008 E/CO/83/2008
(Arising out of Orders-in-Appeal No. P-III/BBP/034/2007 dated 16.03.2007 and No. P-III/PAP/125/2008 dated 30.01.2008 passed by the Commissioner of Central Excise (Appeals), Pune-III).

M/s Kalyani Carpenter Special Steels Ltd. Commissioner of Central Excise, Pune-III	Appellant

Vs.

Commissioner of Central Excise, Pune-III M/s Kalyani Carpenter Special Steels Ltd.	Respondent

Appearance:

Shri M.H. Patil, Advocate	for Appellant

Shri A.B. Kulgod, Asstt. Commissioner (AR)	for Respondent

CORAM:

HON'BLE SHRI RAMESH NAIR, MEMBER (JUDICIAL)
HON'BLE SHRI RAJU, MEMBER (TECHNICAL)

Date of Hearing: 31.01.2018

Date of Decision: 13.04.2018

ORDER NO. **A/86016-86017/2018**

Per: Raju

These appeals have been filed by the Revenue as well as the assessee namely, M/s Kalyani Carpenter Special Steels Ltd. (KCSSL in short). M/s KCCSL are in appeal against Order-in-Appeal dated 16.03.2007, wherein the Commissioner (Appeals) has upheld the order of the original adjudicating authority seeking to include the running royalty in the assessable value of the goods. Revenue is in appeal against order dated 30.01.2008 on identical issue wherein Commissioner (Appeals) has set aside the demand of duty by holding that the said amount of running royalty is not includible in the assessable value. Against the department's appeal, M/s KCSSL has also filed the cross-objection.

2. Learned Counsel for the appellant pointed out that M/s KCSSL are engaged in manufacture of goods in respect of which they had entered into a 'Technology Transfer Agreement' with M/s Carpenter Technology Corporation & CRS Holdings INC, overseas entities. M/s KCSSL were clearing semi-finished goods i.e. Billets/Bars from their Mundhwa Unit to their Ranjangaon Unit where they were further processed and cleared to the market. The unit at Ranjangaon was taken credit of the duty paid on the goods received from Mundhwa unit and was paying duty on the finished goods cleared from the Ranjangaon unit. The goods manufactured by Mundhwa unit were being cleared to Ranjangaon unit on transfer basis, not involving sale and therefore, duty was being paid in terms of Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 by arriving at value as per CAS-4 guidelines. For the technology transfer, M/s KCSSL had paid a fixed technology transfer fee of US$ One Million and were also paying running royalty @ 3.4 to 3.9% of the

Net Sale Value of the licensed products. While the fixed technology transfer fee was being included for the purpose of valuation for payment of duty under CAS-4, a running royalty of 3.4 to 3.9% was not being included. Consequently, show-cause notices for the period of April, 2001 to March, 2005 dated 6.3.2006 and for the period April, 2005 to December, 2005 dated 4.5.2006 were issued. Learned Counsel argued that running royalty is not includible in the value for the purpose of assessment under Rule 8 of the Central Excise Valuation Rules. He further argued that it is revenue neutral situation as the entire duty paid is available as credit in Ranjangaon unit. He further argued that in view of the CAS-4 certificate produced by them it is not open to Revenue to challenge the said certificate without taming an expert opinion.

4. It is seen that Revenue is also in appeal against the order of Commissioner (Appeals) dated 30.1.2008, wherein the Commissioner (Appeals) has dropped the demand for the period April, 2005 to December, 2005 holding that running royalty is not includible in the assessable value. It has been argued that Commissioner (Appeals) has erroneously held that the goods transferred from Mundhwa unit to Ranjangaon unit are not marketable in the condition in which they are transferred and therefore, no royalty are payable to Collaborator in respect of these clearances. Revenue has also raised the issue that M/s KCSSL had

debited the amount of duty in their CENVAT account , however, during the month of May to November, 2005 they did not have that balance in their account. Consequently, they were required to pay an amount of Rs.9,56,332/- in cash.

4.1 Learned AR argued that no distinction can be made in the agreement regarding goods manufactured in the Mundhwa factory, in so far as payment of running royalty is concerned. He argued that the contention of the learned Commissioner (Appeals) that royalty was paid on market expenses is not tenable. He argued that royalty was paid for the technology transfer and therefore, would be applicable to the entire manufacturing process.

5. We have gone through the rival submissions. We find that there are two orders of Commissioner (Appeals), which are diagonally opposite to each other. While in order dated 16.3.2007, the Commissioner (Appeals) has confirmed the demand holding that the said royalty is includible, the order dated 30.1.2008 holds otherwise. The essential issue needs determination is whether running royalty paid by M/s KCSSL is includible in the assessable value of the goods cleared from Mundhwa unit. It is seen that essential argument of the KCSSL is that only royalty based on production is to be included in the direct expenses as per CAS-4. The running royalty being royalty on sales is not

includible in the value for the purpose of CAS-4. A perusal of the technology transfer agreement shows that para 5.2 thereof relates to royalties, which reads as follows: -

> *"In consideration of the grant to the Venture of the rights in respect of the Liccnsed.KHT contemplated hereby the Venture shall pay to CRS a running royalty in respect of each Licensed product for the period specified under Section 10.1 commencing from Commercial Production of each Licensed Product, as follows:*
>
> *(i) 3.7% of Net Sales of Licensed Products by the Venture to the Indian Distribution JV*
> *(ii) 3.9% of 'Net Sales or Licensed Products by the Venture to the Export Distribution Company; and*
> *(iii) 3.4% of Net Sales or Licensed Products by the Venture to all other customers wherever located, including CTC: or its other Affiliates (but excluding sales under (i) or (ii) above).*
>
> *Payments will be made to CRS within thirty (30) 'days after the end or each License Period. Each payment shall be calculated first in the currency in which the sale was made and shall then be converted into U.S. dollars at the exchange rate quoted by the banking institution used by the Venture on the date of remittance. All payments shall be made to CRS in U.S. dollars by wire transfer to such account as CRS shall designate to the Venture in writing from time to time during the License Term."*

It is seen that the heading itself prescribes the royalties in respect of Licensed KHT (Know How Technology). From the above description, it is observed that the running royalty though measured on the basis of value of sale is in respect of technology provided for manufacture of goods. In article 3 of the said agreement, it is envisaged that transfer of technology is in respect of Specialty Alloy Facilities. Exhibit A of the said agreement listed alloy grades, which will be licensed in the agreement. Thus, it is apparent that the technology transfer is used at the stage of costing. In other words, the products manufactured in Mundhwa unit namely, Bloom and Bars, being casting product already contained the technology transfer in the shape of Specialty alloy. Thus, it is apparent that the transferred technology is contained in the intermediate product cleared by the Mundhwa unit. In this regard, Revenue has relied on the decision of the Tribunal in the case of Century Enka Ltd. vide Order No. A/86069-86071/17/EB dated 27.2.2017, wherein after examining the CAS-4 and CAS-1 guidelines, following has been observed: -

> "6. We find that first issue that needs to be decided is if the royalty is includible in value for the purpose of computation under CAS-4. In CAS 1 guidelines following has been provided:
>
> > 6.3.11 ***Research & Development Costs are the cost for undertaking research to improve quality of a present product or improve process of manufacture, develop a new product, market research etc and commercialization thereof.***
> >
> > *6.3.12 Research Cost comprises the cost of development of new product and manufacturing process; improvement of existing products, process and equipment; finding new uses for known products; solving technical problem arising in manufacture and application of products etc. Development cost includes the cost incurred for commercialization / implementation of research findings.*
>
> Exhibit 1
>
> | | |
> |---|---|
> | | *(1) Direct Material Cost (a)* |
> | | *(2) Direct Labour Cost* |
> | | (3) Direct Expenses |
> | (1)+(2)+(3) = | (4) Prime Cost |
> | | (5) Production Overhead |
> | | (6) Administrative Overhead |
> | | (7) Research & Development Cost (apportioned) |
> | (4)+(5)+(6)+(7)= | (8) Cost of Production (b) |
> | | (9) Selling Cost |
> | | (10) Distribution Cost |
> | (8)+(9)+(10) = | (11) Cost of Sales |
>
> Note :
> To arrive at value at different points as indicated above adjustment with opening and closing stock is necessary at following different points :
> (a) opening and closing stock of raw materials
> (b) opening and closing stock of work-in-progress & finished goods
>
> In terms of CAS-1 the research and development cost is part of the cost of production..
>
> In terms of CAS-1 in para 6.2.6 prescribed as under:
>
> *6.2.6 Direct expenses are the expenses other than direct material or direct labour which can be identified or linked with the cost centre or cost object.*

6.2.7 Examples of direct expenses are

- *Expenses for special moulds required in a particular cost centre*
- *Hiring charges for tools and equipments for a cost centre*
- *Royalties in connection to a product*
- *Job processing charges etc.*

It can be seen that expenses of royalties in connection to the product expenses for special moulds, hiring charges for tools and equipments for cost centre and job processing charges are includible.

Para 6.3.7 of CAS-1 prescribed as under :

6.3.7 Selling costs are indirect costs related to selling of products or services and include all indirect cost in sales management for the organization.

6.3.8 Selling Costs include all costs relating to regular sales and sales promotion activities. Examples of expenses which are included in selling cost are :

- *Salaries, commission and traveling expenses for sales personnel*
- *advertisement cost*
- *Legal expenses for debt realization*
- *market research cost*
- *royalty on sale*
- *after sales service cost etc*

It can be seen that differentiation has been made in respect to royalty paid for the product and royalty on sale. Royalty paid for the product would be royalty in respect of technical know how and the technology involved and drawing of the product whereas royalty on sale would be royalty in respect of brand name or trade name associated with the product.

In terms of CAS-4 para 5.3. prescribed as under:

Direct Expenses
Direct expenses are the expenses other than direct material cost and direct employees costs which can be identified with the product.
Direct expenses include:
(i) Cost of utilities such as fuel, power, water, steam etc
(i) Royalty based on production
(ii) Technical Assistance / know –how fees
(iii) Amortized cost of moulds, patterns, patents etc
(iv) Job charges
(v) Hire charges for tools and equipment
(vi) Charges for a particular product designing etc

Thus in terms of CAS-4 royalty of the nature of the technical knowhow is includible in the assessable value, but royalty in the nature of brand or IPR value is not includible. Ld Counsel argued that royalty in the instant case is paid on the sale price of the goods."

Relying on the above decision, we hold that the running royalty is includible in the assessable value of blooms/bars cleared by the KCSSL, as the royalty is not in the nature of brand or IPR but in the nature of Technology Transfer Fee for the purpose of Casting Specialty Alloy.

6. The next issue relates to invocation of extended period of limitation. We find that the appellant has claimed that its unit at Ranjangaon is entitled to CENVAT Credit of the duty paid at Mundhwa unit. The said claim has not been contested by the Revenue. In these circumstances, invocation of extended period of limitation cannot be upheld in view of the decision of the Tribunal in case of *Jay Yushin Ltd. – 2000 (119) ELT 718 (Tri-LB).*

7. The next issue relates to imposition of penalty under Section 11AC in respect of appeal filed by the KCSSL. In view of the fact that no allegation of suppression/mis-declaration can be upheld, the penalty under Section 11AC is set aside.

8. In respect of the issue regarding payment of duty amounting to Rs.9,56,332/- ordered to be paid in cash, it is seen that the impugned order dated 30.01.2018 does not deal with this aspect, as the demand of duty was dropped on merit. In view of the fact that now the demand of duty has been upheld on merit, but allowed partly on limitation, the fact needs to be re-verified by the Commissioner (Appeals).

9. In view of the above, the appeal No. E/403/08 is allowed partly by way of remand on above terms. The appeal No. E/921/07 is partly allowed. The order is upheld on merits but benefit of limitation is allowed.

10. In appeal No. E/921/07, the goods which are not available have been ordered to be confiscated and redemption fine has been imposed. It is settled law that when the goods is not available for confiscation, no redemption fine can be imposed. In view of above, redemption fine imposed is set aside.

11. Appeals are partly allowed in the above terms. Cross-objection is also disposed off.

(Pronounced in Court on 13.04.2018)

(Ramesh Nair)
Member (Judicial)

(Raju)
Member (Technical)

Sinha