

# S.MURUGAPPAN

ADVOCATE, HIGH COURT

**ASSISTED BY:**

K.NANCY, B.COM., B.L. (HONS.),  
G.GAUTHAM RAM VITTAL, L.L.B.

**CONSULTANTS:**

GST, CUSTOMS, FOREIGN TRADE LAWS,  
FOREIGN EXCHANGE MANAGEMENT ACT.

## OPINION

**1. Querist :**

M/s. Alchymars ICM SM Private Limited  
No. 17, III Floor, Adwave Towers,  
South Boag Road,  
Chennai – 600 017.

**2. Facts :**

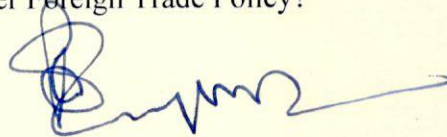
- 2.1 Querist is an API Manufacturer and regularly supplies the API called CLINDAMYCIN HCL USP (API) to LABORATÓRIO TEUTO BRASILEIRO S/A, Brazil (Teuto) for production of medicines.
- 2.2 Teuto is the querist's valuable export customer. Out of the querist's earlier supplies, 9188 Kgs. of API were not approved by the customer's agency called ANVISA. Hence Teuto returned 2906.12 Kgs. which were in their warehouse to the querist and API which were in their further manufacturing processing was totally destroyed by Teuto.
- 2.3 Teuto have paid for the entire quantity of materials sent to them. Now they are claiming USD 661510.50 towards compensation for the damage incurred by them by processing the querist's API.
- 2.4 Since the querist's financial position is not supportive to pay off the damage of 661510.50, they have the following proposal with Teuto.
- 2.5 Teuto agrees to purchase API from the querist for 5 years for a total quantity of 36000 Kgs. Average quantity per year will be 7200 Kgs. at a price of USD 140 per Kg. based on lincomicycyn (RM) cost (price \$140) will be valid for the first 6 months; later it will be reviewed based on lincomycin cost. Along with every PO, querist should supply 10% of the PO quantity as Free of Cost to compensate the damage. This FOC material will be accounted at USD 180 per Kg. (fixed for compensation).

**3. Query :**

In this context, querist seeks clarification on the following:

- 3.1 Is it possible to export material at Free of Cost as per this agreement since the API of the querist has gone into production of medicine by Teuto which was destroyed subsequently ? What is the permissible quantity of FOC for Alchymars that can be exported under Foreign Trade Policy?

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- 3.2 Is there any timeline for completing Free of Cost export by law. (Customs, FEMA etc.)
- 3.3 Who are all the departments to provide approval for this export, in case this is possible.
- 3.4 What are all the documents to be provided and to whom for getting approval?
- 3.5 Procedure of approval. To whom the querist should approach first and subsequent departments.
- 3.6 How will be customs valuation impact?
- 3.7 How to invoice the same?
- 3.8 Whether IGST is to be paid against the same at the time of export itself. The querist is exporting with LUT under GST. Impact on FOC material?
- 3.9 Whether FTP incentives can be availed for the same?

**4. Opinion :**

- 4.1 To compensate the loss suffered by the buyer, it is not possible to supply goods free of charge on subsequent dates to adjust the loss. Such goods cannot be supplied as free supplies. The value of the supply for which remittance is to be made also has to be in accordance with Customs Valuation Rules and should represent fair market price without being influenced by other considerations.
- 4.2 With regard to export of samples, querist's attention is invited to para.2.66 of the handbook of current Foreign Trade Policy according to which, only export of **bonafide** trade and technical samples of freely exportable goods will be allowed without any limit. In the present case, the goods proposed to be sent as free supplies cannot be called as 'bonafide trade' or 'technical samples' and as such, it will be required that for the goods exported, export proceeds are realised in full. As per the master directions on export of goods and services issued by the Reserve Bank of India, the above will be one of the requirements to be complied with. Para A2 in the above directions issued by RBI with regard to realization and repatriation of proceeds of export goods reads as follows:

***"A.2 Realization and repatriation of proceeds of export of goods / software / services***

*It is obligatory on the part of the exporter to realize and repatriate the full value of goods / software / services to India within a stipulated period from the date of export, as under:*



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(i) *It has been decided in consultation with the Government of India that the period of realization and repatriation of export proceeds shall be nine months from the date of export for all exporters including Units in Special Economic Zones (SEZs), Status Holder Exporters, Export Oriented Units (EOUs), Units in Electronic Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) & Bio-Technology Parks (BTPs) until further notice.*”

4.3 Apart from the above, it may be noted that the transaction value declared to customs should be in accordance with the provisions of Section 14 of Customs Act and the Customs Valuation (Determination of Value of Export Goods) Rules 2007. Section 14 referred to above reads as follows:

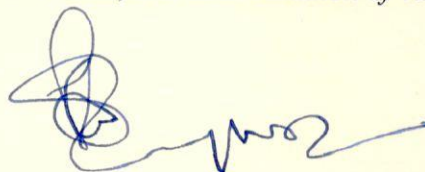
**“SECTION 14. Valuation of goods. — (1)** *For the purposes of the Customs Tariff Act, 1975 (51 of 1975), or any other law for the time being in force, the value of the imported goods and export goods shall be the transaction value of such goods, that is to say, the price actually paid or payable for the goods when sold for export to India for delivery at the time and place of importation, or as the case may be, for export from India for delivery at the time and place of exportation, where the buyer and seller of the goods are not related and price is the sole consideration for the sale subject to such other conditions as may be specified in the rules made in this behalf :*

*Provided that such transaction value in the case of imported goods shall include, in addition to the price as aforesaid, any amount paid or payable for costs and services, including commissions and brokerage, engineering, design work, royalties and licence fees, costs of transportation to the place of importation, insurance, loading, unloading and handling charges to the extent and in the manner specified in the rules made in this behalf :*

**Provided further that the rules made in this behalf may provide for,-**

- (i) *the circumstances in which the buyer and the seller shall be deemed to be related;*
- (ii) *the manner of determination of value in respect of goods when there is no sale, or the buyer and the seller are related, or price is not the sole consideration for the sale or in any other case;*
- (iii) *the manner of acceptance or rejection of value declared by the importer or exporter, as the case may be, where the proper officer has reason to doubt the truth or accuracy of such value, and determination of value for the purposes of this section :*

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*Provided also that such price shall be calculated with reference to the rate of exchange as in force on the date on which a bill of entry is presented under section 46, or a shipping bill of export, as the case may be, is presented under section 50.*"

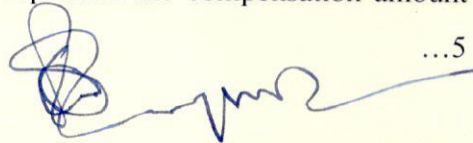
Rules 7 and 8 of Customs Valuation Rules mentioned above read as follows:

*"RULE 7. Declaration by the exporter. — The exporter shall furnish a declaration relating to the value of export goods in the manner specified in this behalf.*

*RULE 8. Rejection of declared value. — (1) When the proper officer has reason to doubt the truth or accuracy of the value declared in relation to any export goods, he may ask the exporter of such goods to furnish further information including documents or other evidence and if, after receiving such further information, or in the absence of a response of such exporter, the proper officer still has reasonable doubt about the truth or accuracy of the value so declared, the transaction value shall be deemed to have not been determined in accordance with sub-rule (1) of rule 3.*

*(2) At the request of an exporter, the proper officer shall intimate the exporter in writing the ground for doubting the truth or accuracy of the value declared in relation to the export goods by such exporter and provide a reasonable opportunity of being heard, before taking a final decision under sub-rule (1)."*

- 4.4 In the light of the above, the value declared to customs should represent the fair market value for the subject goods at the relevant time and place. It will not be possible to have USD 140 per kg. for charged goods and USD 180 per kg for free supplies when the prevailing market price is something different from these two values.
- 4.5 In view of the above, any attempt to make supplies at reduced prices for the purpose of compensating the loss suffered by the buyer or resorting to free supply of goods for a fixed period will be a direct violation of the provisions of Customs Act as well as Foreign Exchange Management Act.
- 4.6 In view of the above, the replies to other queries will not arise.
- 4.7 At the same time the querist has indicated that as per the conditions of supply and as the present buyers are one of the main customers, they have to compensate the buyer's losses. For this purpose, the querist can approach Reserve Bank for specific permission to repatriate the compensation amount

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agreed to. Outward remittance is regulated in terms of ***Foreign Exchange Management (Current Account Transaction) Rules 2000***. As per these regulations, drawal of foreign exchange is prohibited in respect of activities covered by Schedule I and in respect of activities covered by Schedule II, prior approval by the government is necessary. Schedule III refers to certain facilities provided for individuals and also other than individuals. There is no specific reference to payment of compensation in these schedules. Considering this aspect, it will be advisable that the querist approaches their foreign exchange dealer and the Reserve Bank of India and seeks necessary clarification as well as approval. Any other procedure to transfer the compensation amount by other adjustments will result in violation of the provisions mentioned above and will invite penal proceedings.



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**Disclaimer:-** The above opinion is provided based on the information and documents made available to us by the querist and further based on the laws and rules prevalent as on date and the understanding of such provisions by the author and is meant for the private use of the person to whom it is provided without assuming any liability for any consequential action taken based on the views expressed here.