2005 (192) E.L.T. 314 (Tri. - Mumbai)

IN THE CESTAT, WEST ZONAL BENCH, MUMBAI

S/Shri S.S. Sekhon, Member (T) and T. Anjaneyulu, Member (J)

COMMISSIONER OF CUSTOMS (IMPORT), MUMBAI

Versus

TITEX INDIA PVT. LTD.

Order No. A/235/2004-WZB/C-II, dated 21-12-2004 in Appeal No. C/621/2003-Mum.

Valuation (Customs) - Import - Royalty payment, made in relation to manufacture of goods in India - Agreement, terms of - Royalty payments not includible in assessable value when, under the agreement, these relate solely to use of know-how and patent and trade-mark rights granted thereunder in production and manufacture, in India, of specified finished goods, are payable only in relation to local production of specified goods, payment of royalty is not a condition of sale of any imported goods, and in fact assessee frequently imported raw materials and components from third parties - Such royalty payments, having no connection, direct or indirect, with what is imported, nor being a condition of sale of any imported goods - Rule 9(1)(c) of Customs Valuation Rules, not attracted - Revenue appeal rejected - Rule 9(1)(c) of Customs Valuation Rules, 1988 - Section 14 of Customs Act, 1962. *[1995 (76) E.L.T. 481 (S.C.) relied]. [para 3.1(d)]*

Appeal rejected

CASES CITED

Collector v. Essar Gujarat Ltd. — 1996 (88) E.L.T. 609 (S.C.) — *Referred*.................. [Paras 1, 2, 3.1]
Collector v. Maruti Udyog Ltd. — 1987 (28) E.L.T. 390 (Tribunal) — *Referred*................... [Para 3.1]
Collector v. Maruti Udyog Ltd. — 1989 (41) E.L.T. A61 (S.C.) — *Referred*.......................... [Para 3.1]
Commissioner v. Himson Textile Engg. Indus — 1997 (93) E.L.T. 301 (Tribunal) — *Referred* [Para 3.1]
Ferodo India Pvt. Ltd. v. Commissioner — 2002 (142) E.L.T. 343 (Tribunal) — *Relied on*... [Para 3.1]
Himson Textiles Engg. Industries Ltd. v. Commissioner — 2000 (117) E.L.T. 535 (S.C.) — *Referred* [Para 3.1]
Hoerbiger India Pvt. Ltd. v. Commissioner — 2003 (156) E.L.T. 62 (Tribunal-LB) — *Relied on* [Para 3.1]
Mando Brake Systems India Ltd. v. Commissioner — 2004 (163) E.L.T. 333 (Tribunal) — *Referred* [Para 3.1]
Panalfa Dongwon India Ltd. v. Commissioner — 2003 (155) E.L.T. 287 (Tribunal-LB) — *Relied on* [Para 3.1]
S.D. Technical Service v. Commissioner — 2003 (155) E.L.T. 274 (Tribunal-LB) — *Relied on* [Para 3.1]
State Bank of India v. Collector — 2000 (115) E.L.T. 597 (S.C.) — **Distinguished**..... [Para 1, 2, 3.1]
Union of India v. Mahindra & Mahindra Ltd. — 1995 (76) E.L.T. 481 (S.C.) — *Relied on*.... [Para 3.1]
Vestas RRB India Ltd. v. Commissioner — 2004 (178) E.L.T. 636 (Tribunal) — *Referred*...... [Para 3.1]

REPRESENTED BY : Shri Sanjay Singhal, JDR, for the Appellant.
Shri Atul Setalwad, Advocate, for the Respondent.

[Order per : S.S. Sekhon, Member (T)]. - Heard both sides and it is found -

(i) The Revenue is aggrieved by the decision of the Commissioner of Customs (Appeals) who has upheld the observation of the Deputy Commissioner of Customs that even though the Royalty payment is to be made in future, the subject Royalty is not related to the imported goods and also there is no condition of sale attached with the agreements, therefore the Royalty payment is not covered by Rule 9(1)(c) of the Customs Valuation Rules 1988. Accordingly, the authority vide Order-in-Original dated 27-4-2001 ordered to accept the invoice value under Rule 8 of Customs Valuation Rules, 1988.

(ii) The Adjudicating Authority while accepting the transaction value under Rule 4(3) of the Customs Valuation Rules, 1988 has ignored the legal fact that it is mandatory to make addition in terms of Rule 9 of Customs Valuation Rules, 1988 with regard to includability or otherwise of the technical know how fees and or royalty paid/payable by the Indian Company to the foreign collaborator.

(iii) The Indian Collaborator Company manufactures and sells the licensed goods i.e. high-speed tools which are manufactured using the technical know how provided by the collaborator under their brand name. They have imported HSS blanks for taps from M/s. Dormer Tools AB, Sweden and HSS & solid carbide cutting tools such as drills taps, end mills etc. are imported from Gunther Co. GmbH, Germany. Under the collaboration agreement Indian Company is allowed to manufacture and sell products as per designs, trademarks and patents of their foreign collaborators. The technical know how and royalty are related to the imported goods because such imports are of no value unless they are processed/manufactured in accordance with the manufacturing process contained in the technical documentation supplied by the collaborator to achieve their objective. Therefore, the importer has to pay not only priced of the goods but also fees for obtaining the technical know how and license to obtain the right to exclusive use of the same.

(iv) The adjudicating authority has held that the royalty is not related to the imported goods and there is no condition of sale attached with the agreements and royalty payment is not covered by Rule 9(i)(c) of the Customs Valuation Rules, 1988. However, as per the agreement Indian Company purchase HSS blanks for Taps from M/s. Dormer Tools AB, Sweden and HSS and solid carbide cutting tools such as drills taps and mills from M/s. Gunther and Co. GmbH Germany. The Indian Company has also imported capital goods and machinery from their collaborators and associate companies. It can be seen that the import of such goods has been started before signing of the agreement wherein the payment of royalty at the rate of 5% of net sales are conditions of the agreement.

(v) The issue of includability of technical know-how/licence fee was discussed in detail in judgement passed by the Hon'ble Supreme Court in the matter of *M/s. Essar Gujarat Limited* [1996 (88) E.L.T. 609 (S.C.)] and *State Bank of India* v. *Collector of Customs, Bombay* [2000 (115) E.L.T. 597 (S.C.)] and the same are clearly applicable to the present case also. In the present case M/s. Titex India Pvt. Ltd. vide letter dated 5-4-1999 had obtained R.B.I's permission to make payments towards foreign technology transfer DEM 13,00,000/- and royalty @ 3% to their collaborators, however subsequently they requested and obtained R.B.I's approval vide letter dated 19-11-1999 to pay royalty of 5% to their collaborators instead of DEM 13,00,000/- and royalty @ 3% to their collaborators. This shows that M/s. Titex India Pvt. Ltd. is misleading the department by adjusting the technical know how fees in guise of enhanced royalty.

(vi) Therefore, the royalty amount @ 5% is clearly includible in the value in terms of Rule 9(i)(c) of Customs Valuation Rules, 1988.

(vii) Accordingly he directed DC/GVC to file Appeal before Commissioner (Appeals) to set aside the Order-in-Original dated 27-4-2001 and remand the case back to the lower authority for *de novo* consideration.

2. On the grounds that -

(i) Commissioner (Appeal) has observed that there is no condition of Sale. Hence Technical Know-how fees and Royalty is not addable. This observation is erroneous. Royalty and Technical Know-how fee in the instant case is related to the imported goods as they are given for the right to Titex India Pvt. Ltd. for which payments is made. Attention is drawn to para 2.4(1)(b) of the agreement dated 10-12-1999 which is as under 2.4(1)(b):- the right for Titex to acquire equipment at prices, terms and conditions to be separately agreed upon. This clause clearly indicates that the parties have agreed upon separate terms for the price of equipments.

(ii) Under the term "Consideration" of the agreement, sub section 6.2 states :

> "The Royalty shall be 5% (Five per cent) of the NPS (Net proceeds of sales) of products sold by Titex Royalty shall be payable for a period of seven (7) years from the effective date. Here effective date means the date of manufacturing with the help of Technical Know-how and in context of above it is pertinent to note that as per RBI's approval dated 5-4-1999 submitted by the party, they have taken approval to make payment towards Technical Know-how fees of DEM 13,00,000/- and Royalty @ 3% on domestic sales for a period of 7 years and @ 3% on exports for a period of 7 years. Subsequently they obtained RBI's approval dated 19-11-1999 to pay Royalty @ 5% to their collaborators instead of DEM 13,00,000/- & Royalty @ 3% to their collaborator. It is important to note that they filed B/E No. 8783 dated 28-6-98 for import from their related supplier, i.e. M/s. Gunther & Co. GmbH, Germany. It means that they have imported the materials from their foreign collaborators much before the RBI's approval for lump sum and running royalty payment has been taken. When the case is taken for investigation into the valuation aspect, they approached RBI to change lump sum payment and 6% running royalty to 5%. This clearly indicates that the importer has adjusted the Technical transfer fees of DEM 13,00,000/- by Royalty of 5% and 3% royalty on domestic sales and 3% on exports towards the imports of equipments which is a separately agreed upon as a condition of sale."

(iii) Commissioner (Appeal) has stated in his order that the importer have been purchasing the imported raw material from some unrelated parties which means that there was no condition which bound the respondents to buy the goods from the foreign collaborator only.

In the reply of questionnaire dated 14-8-2000 by the importer, they themselves have declared at Point No. VI that they have imported capital goods from associate cos and not from collaborator. It shows that they have imported goods from related party i.e. associate company.

(iv) Commissioner (Appeal) in his order has stated that Royalty has not been paid at all, and no documentary evidence has been produced to contradict this factual position.

This is factually not correct. Party vide their letter dated 2-2-2001 have stated that so far they have not made any payment towards royalty. But vide C.A' certificate of inspection of their company accounts dated Nil it is clearly mentioned that Royalty is payable in the following matter:-

Royalty	-	Net or Gross Payable.		
April 1998	-	March 1999	-	Nil

April 1999	-	March 2000	-	Rs. 893380/-
			Tax-	Rs. 89338/-
				Rs. 982718/-

(v) The issue of includability of technical know-how/licence fee was discussed in detail in judgement passed by the Hon'ble Supreme Court in the matter of *M/s. Essar Gujarat Limited* [1996 (88) E.L.T. 609 (S.C.)] and *State Bank of India* v. *Collector of Customs, Bombay* [2000 (115) E.L.T. 597 (S.C.)] and the same are clearly applicable to the present case also. In the present case M/s. Titex India Pvt. Ltd. vide letter dated 5-4-1999 had obtained R.B.I's permission to make payments towards foreign technology transfer DEM 13,00,000/- and royalty @ 3% on domestic sales and 3% on export to their collaborators, however subsequently they requested and obtained R.B.I's approval vide letter dated 19-11-1999 to pay royalty of 5% to their collaborators instead of DEM 13,00,000/- and royalty @ 6% to their collaborators. This shows that M/s. Titex India Pvt Ltd. is misleading the department by adjusting the technical know how fees in guise of only 5% royalty.

Therefore, the royalty amount which is payable/paid is clearly includible in the value in terms of Rule 9 (i)(c) of Customs Valuation Rules, 1988.

3.1 (a) For the sake of convenience, the Respondents are referred to as "Titex" & Titex entered into an agreement with (a) Dormer Tools AB (Swedan) and (b) Gunther GMBH (Germany) ("CTT", both of whom were part of the CTT tools business of the Sandvik group). Under this agreement, CTT allowed the benefit of the know how, patents and trade mark rights in respect of the specified products, viz., high speed steel taps, solid carbide cutting tools, etc., which Titex was manufacturing in India. Titex were under no obligation to buy components etc. from CTT as originally proposed, it was agreed that Titex would pay to CTT as royalty a lump sum of DM 1.3 million and 3% on domestic and export sales of the said specified products to be manufactured by Titex in India. The Reserve Bank of India has approved the proposed agreement by its letter dated 5-4-1997. However, before the agreement was executed it was realized that Titex would not be in a financial position to pay such amounts and the terms relating to royalty was revised so that instead of the said lump sum and royalty of 3%, Titex would pay *only* a royalty of 5% on the "N.P.S". "NPS" was defined to mean the sale price of the said specified products exclusively of excise duty and minus the cost of the standard bought out items and the landed cost of the imported components. In other words, the royalty was to be computed only on the domestic element of the net sale price (exclusive of excise duty) of the said specified products. The Reserve Bank approved the alteration by its letter dated 19-11-1999 and the agreement was entered into on 10-12-1999 and the agreement came into effect from 1-1-2000.

(b) The contention in the grounds of appeal that the alteration of the terms of the agreement was effected by way of an 'adjustment' to cover the cost of imports effected in June, 1998 (before the date of the agreement) is wholly unwarranted as –

(i) no such contention was ever raised earlier

(ii) no evidence whatever is produced to support the contention.

(iii) the contention ignores the fact that Titex had explained to the Reserve Bank as to why the terms of the agreement were altered, viz, that the Company (i.e. Titex) will not be in a position to generate the required funds to make the approved payments. (See the letter of Titex to the Reserve Bank of India dated 13th October, 1999). There is no evidence whatever to show that the said reason was false.

(iv) The fact that the agreement was not in any way connected to the import of equipment as the collaborators did *not* (under the agreement or otherwise) supply any equipment but merely an agreement to assist Titex to manufacture the stated end products in India.

(v) Reliance on clause 2.4(1)(b) is misconceived as the collaborators merely *advised* and assisted on the prices, terms and conditions of equipment and did not supply it. Reliance by the Respondent in this connection *Ferodo India (P) Ltd.* v. *Commissioner of Customs, Mumbai* - 2002 (142) E.L.T. 343 (Tribunal) is well placed.

(c) The question of certificate of Chartered Accountants is also misconceived as merely specifies a certain amount as "payable". Titex has always maintained that no royalty was paid at the time *and there is no evidence produced to show that the said contention, which is purely a question of fact was false*.

(d) A perusal of the agreement shows that

(i) it relates solely to the use of the know how and patent and trade marks rights granted thereunder in the production and manufacture *in India* of the said specified finished goods.

(ii) The royalty payable thereunder is only related to such local production of the said specified goods.

(iii) The agreement does not relate to the import of any goods at all.

(iv) It is a finding of fact that Titex has frequently imported raw materials and components from third parties,

(v) It therefore has to follow that the royalty payments in this case have no connection, direct or indirect, with what is imported and that the payment of such royalty is not the condition of sale of any imported goods. Under Rule 9(1)(c) of the Customs Valuation Rules, 1988, royalty and licence fees can be added only if (1) they are related to the imported goods, and (2) if the buyer is required to pay them as a condition of the sale of the imported goods. In *Union of India* v. *Mahindra & Mahindra Ltd.* - 1995 (76) E.L.T. 481, the Supreme Court has held that there was no nexus and connection between the royalty payment and the import. In coming to this conclusion, the Supreme Court relied on the fact that the Indian importer was under no obligation to import from the foreign party as in this case. The Respondent are therefore entitled to the benefits as arrived at by lower authority.

(e) The reliance placed on *Collector of Customs (Prev.). Ahmedabad* v. *Essar Gujarat Ltd.* - 1996 (88) E.L.T. 609 (S.C.) is not relevant, as in that case the licence from Midex (and payment for such licence) was a condition precedent to the import of the plant.

In that case, the agreement was for the supply of design specifications and know-how in connection with the manufacture of goods in India. The Tribunal, relying on the judgment of the Supreme Court in *Collector of Customs (Prev.), Ahmedabad* v. *Essar Gujarat Ltd.* - 1996 (88) E.L.T. 609. This contention urged by the department was precisely what this Hon'ble Tribunal held in *Commissioner of Customs, Mumbai* v. *Himmson Textile Engg. Indus. Ltd.* - 1997 (93) E.L.T. 301 held that royalty had to be added. The Tribunal observed that the decision of the Supreme Court in *Union of India* v. *Mahindra & Mahindra Ltd.* - 1995 (76) E.L.T. 481 was under the Customs Valuation Rules, 1963, whilst the decision in *Essar Gujarat* case was under the 1988 Valuation Rules. In *Himson Textiles Engr. Indus. Ltd*. v. *Commissioner of Customs, Mumbai* - 2000 (117) E.L.T. 535 the Supreme Court ***set aside*** the said order of the Tribunal, observing that *Essar Gujarat* decision had no application to the facts, and directed the Tribunal to determine the matter afresh in the light of *Mahindra & Mahindra* and *Collector* v. *Maruti Udyog Ltd.* - 1987 (28) E.L.T. 390. The decision of the Tribunal in *Commissioner of Customs, Mumbai* v. *Himson Textile Engg. Industries Ltd.* - 1997 (93) E.L.T. 301 (which had relied on *Collector of Customs (Prev.), Ahmedabad* v. *Essar Gujarat Ltd.* - 1996 (88) E.L.T. 609, and not on either *Union of India* v. *Mahindra & Mahindra Ltd*. - 1995 (76) E.L.T. 481 and *Collector of Customs, Bombay* v. *Maruti Udyog Ltd., Gurgaon* - 1987 (28) E.L.T. 390, affirmed by the Supreme Court in 1989 (41) E.L.T. A61, was not good law and was set aside by the Supreme Court in *Himson Engr. Indus. Ltd.* v. *Commissioner of Customs, Mumbai* - 2000 (117) E.L.T. 535, was recognized by the Tribunal in *Vestas RRB India Ltd*. v. *Commissioner of Customs, Chennai* [2004 (178) E.L.T. 636 (Tri.) = (2000) 41 R.L.T. 645] and *Mando Brake Systems India Ltd.* v. *Commissioner of Customs, Chennai* - 2004 (163) E.L.T. 333. It is therefore, clear that *Collector of Customs (Prev.), Ahmedabad* v. *Essar Gujarat Ltd.* has no application whatever in *the present case* where the royalty or licence fee relates to post importation manufacture in India, and the contention is wholly untenable.

(f) *State Bank of India* v. *Collector of Customs, Bombay* - 2000 (115) E.L.T. 597 (S.C.) dealt with the licence fee payable in respect of imported software. The amount was payable, and paid, as a part of the purchase price of such imported software. This judgment has no relevance whatever in the present case.

(g) In view of the facts herein as regards the nature of payments, the same cannot be added fully in Larger Bench decision in case of *Hoerbiger India Pvt. Ltd.* - 2003 (156) E.L.T. 62, *SDT Scheme Service* [2003 (155) E.L.T. 274]. *Panalfa Dongwon India Ltd.* [2003 (155) E.L.T. 287].

3.2 In view of the findings, this appeal of Revenue is required to be rejected.

3.3 Ordered accordingly.

(Pronounced in Court)