

SUPREME COURT OF INDIA

I. T. C. Ltd.

Vs.

Collector of Central Excise, Patna

C.A.Nos.6402-05 of 1995

(S. N. Variava and B. N. Agrawal JJ.)

10.12.2002

JUDGEMENT

B. N. Agrawal, J.

1. The order impugned in these appeals was passed by Customs, Excise and Gold (Control) Appellate Tribunal (hereinafter referred to as 'the Tribunal') in appeals preferred against the orders of assessing authorities whereby excise duty was levied and penalty imposed.

2. The short facts are that four show cause notices were issued to the appellant-Company, which was manufacturer of cigarette, alleging therein that it had been clearing without payment of excise duty 20 sticks of cigarette from each cigarette making machine in the cigarette making department on each working day as samples for test in their quality control laboratory within the factory premises, total quantity each day being 65 packets of cigarettes of each brand manufactured in the factory. It was further alleged that the company neither submitted any classification list nor maintained any account in respect of quantity of cigarettes removed, which was liable to excise duty. Out of the aforesaid show cause notices, first show cause notice was issued by the Collector of Central Excise, Patna on 25th July, 1990 and the appellant-company was required to pay excise duty to the tune of Rs. 65,45,630.32 besides penalty in relation to the period from March 1973 to April 1990 under the provisions of *Central Excise Act, 1944* (hereinafter referred to as 'the Act') and the rules framed thereunder which was issued in case No. 6-MP of 1991. Other three notices were issued in the months of January and February, 1991 by the Additional Collector of Central Excise, Patna, in relation to period between May and December, 1990 in case Nos. E-522, E-523 and E-524 of 1992 and total amount of excise duty leviable upon the appellant company was Rs. 6,14,278.48 besides penalty.

3. The appellant company contested the demand on grounds, inter alia, that no duty was leviable on samples of cigarettes drawn for test purposes in the quality control laboratory within the factory since the process of manufacture of cigarettes is not completed until the same are packed as packing is a process incidental or ancillary to the process of manufacture

of cigarettes and packing of cigarettes is done after the samples sent are tested in the laboratory. According to it, some quantity of cigarettes is destroyed in the process of testing.

4. The assessing authorities by two separate orders disposed of the proceedings. In one case, excise duty was levied to the tune of Rs. 65,45,630.32 and penalty to the tune of Rs. 5 lacs and in another case, Rs. 6,14,278.48 apart from penalty of Rs. 15,000/-. The assessing authorities passed the orders after holding that the manufacturing process in respect of the cigarettes is completed at the stage when they emerge in the form of sticks of cigarettes and excise duty under the provisions of S. 3 of the Act on the manufacture or production of the final article, i.e., in the case of cigarette, was attracted at that very stage even though collection was deferred until clearance. It was further held that the process of packing of cigarettes was not incidental or ancillary to manufacture but it was incidental or ancillary to the sale of the end products.

5. Challenging orders passed by the assessing authorities, four separate appeals were filed on behalf of the appellant company before the Tribunal which have been disposed of by a common order whereby the Tribunal has decided the question of law raised against the assessee holding that excise duty is leviable on the samples of cigarettes sent to the laboratory for the purposes of test within the factory premises but remitted the matter to the assessing authorities for a limited purpose for working out the effective excise duty recoverable on the disputed quantity of cigarettes. Hence these appeals.

6. Shri S. Ganesh, learned Senior Counsel appearing in support of the appeals, submitted that in terms of Rule 93 of the Central Excise Rules, 1944 (hereinafter referred to as 'the Rules'), no excisable tobacco products can be delivered from any factory unless the same are made into separate packets and enclosed in a wrapper bearing, inter alia, the name of the factory and the licence number which can be done only after the completion of testing and thus as the process of manufacture of cigarette was not completed, no excise duty is leviable thereon. Alternatively, it was submitted that certain quantity of cigarette is destroyed during the process of testing whereupon no excise duty is leviable.

7. Shri Mukul Rohtagi, learned Additional Solicitor General, appearing on behalf of the respondent, on the other hand, submitted that manufacture of cigarette within the meaning of S. 2(f) of the Act is completed no sooner they are converted into sticks of cigarettes and the process of packing into separate packets and wrapping the same is neither incidental nor ancillary to the completion of manufacture of cigarette, but the same may, at the highest, be incidental or ancillary to its sale. Learned Additional Solicitor General further submitted that it is not known as to whether any quantity of cigarette was at all destroyed during the process of testing and if at all there was any destruction, what was its quantum as no account in this regard was either maintained or produced either before the assessing authority or the Tribunal.

8. In view of the submissions made on behalf of the parties, questions that fall for consideration of this Court are :-

“1. Whether cigarettes removed for the purposes of tests in the quality control laboratory situated within the factory premises could be treated to be excisable goods manufactured and consequently liable to payment of excise duty under the provisions of the Act.

2. Whether excise duty is leviable on the cigarettes that are destroyed during the process of testing in the laboratory.”

9. In order to appreciate the points raised, it may be useful to refer to the provisions of Ss. 2(d), 2(f) and 3(1)(a) of the Act and Rule 93 of the Rules which run thus :-

"S. 2.- Definitions.- In this Act, unless, there is anything repugnant in the subject or context,-

(d) "excisable goods" means goods specified in the *First Schedule and the Second Schedule to the Central Excise Tariff Act, 1985 (5 of 1986)* as being subject to a duty of excise and includes salt;

(f) "manufacture" includes any process-

(i) incidental or ancillary to the completion of manufactured product;

(ii) which is specified in relation to any goods in the section or Chapter notes of the *Schedule to the Central Excise Tariff Act, 1985 (5 of 1986)* as amounting to manufacture, and the word "manufacturer" shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account."

"Section 3. Duties specified in the Schedule to the Central Excise Tariff Act, 1985 to be levied.- (1) There shall be levied and collected in such manner as may be prescribed,-

(a) a duty of excise, to be called the Central Value Added Tax (CENVAT) on all excisable goods which are produced or manufactured in India as, and at the rates, set forth in the First Schedule to the Central Excise Tariff Act, 1985 (5 of 1986)".

"R. 93. Manufacture and disposal of excisable tobacco products.- No excisable tobacco products shall be delivered from any factory except under the following conditions :-

(a) Such products shall be made into separate packets.

(b) Each such packet, whether retail or wholesale, shall be enclosed by, and at the expense of, the manufacturer, in a wrapper or other outer covering, and, unless

exempted by the Central Board of Excise and Customs, by general or special order, each such packet, or the manufacturer's label affixed thereto, shall bear in clearly discernible characters, the following particulars -

(i) the name of the factory or a distinguishing mark which may take the form of a special design whereby the origin of the products can be traced;

(ii) the number of his licence in Form L4; and

(iii) the trade brand of the product, specimens of all such wrappers, outer covering or labels shall be submitted to the Collector for his approval before they are brought into use.

(c) An application for clearance in the proper form shall be delivered to the officer-in-charge of the factory at least 12 hours (or such other period as the Collector may in any particular case require or allow before it is intended to remove the goods :

Provided that where removals from a factory are frequent and the manufacturer maintains a sufficient credit balance in his account-current maintained under Rule 9 for payment of duty, the Assistant Collector may, on a request by the Manufacturer permit, by an order in writing, removal of goods on presentation of a gate-pass as prescribed under Rule 52-A, subject to the observance of such procedure as may be prescribed in this regard by the Collector.

(d) No cigars and cherrots mentioned in Heading No. 24.02 of the Schedule to the Central Tariff Acts 1985 (5 of 1986) shall be delivered from any factory unless-

(1) they are put into packets containing 5, 10, 25, 50 or 100 cigars or cheroots, as the case may be;

(2) each such packet consists of a wooden, tin or cardboard box opening only at the top or of a paper wrapper top completely closed on all sides and with all sides and with all outer edges gummed down".

10. Excise duty is leviable under Section 3 of the Act on all excisable goods which are produced or manufactured in India at the rates, set forth in the First Schedule to the Central Excise Tariff Act, 1985 (hereinafter referred to as 'the Tariff Act'). The expression 'Excisable goods' has been defined under Section 2(d) of the Act to mean goods specified in the First Schedule and the Second Schedule appended to the Tariff Act as being subject to a duty of excise. 'Tobacco' has been enumerated as excisable goods as item No. 1 in Second Schedule to the Tariff Act. The expression 'manufacture' has been defined under Section 2(f) of the Act to include any process incidental or ancillary to the completion of a manufactured product. Under Rule 93 of the Rules excisable tobacco products, which include cigarette, shall be delivered from the factory after the products are made into separate packets after affixing manufacturer's label thereon and wrapping in a wrapper or other outer covering.

11. According to Shri Ganesh, excisable goods contemplated by Section 3(1)(a) of the Act are those goods which are marketable inasmuch as the cigarettes removed for the purposes of testing in the quality control laboratory situated within the factory premises are not marketable as the process of its manufacture was not completed, the same having not been kept in packets as required under Rule 93 of the Rules.

12. The requirement of "marketability" has been evolved by a process of judicial interpretation for which it would be necessary to refer to the relevant decisions hereinafter.

13. In the case of *Union of India v. Delhi Cloth and General Mills*¹ the respondent-Mills were engaged in the manufacture of vegetable product known as 'Vanaspati'. Vanaspati was subject to duty. It was the common case of both the parties that for the purpose of manufacturing vanaspati, the respondent-Mills purchased groundnut and 'til' oil from the market and subjected them to different processes before applying hydrogenation to produce vanaspati. The stand of the Union of India was that in the course of manufacture of vanaspati, the respondent-Mills produced at an intermediate stage what is known as 'refined oil' in the market and although the respondent may not sell it as such, still it being a marketable product, it was liable to excise duty under Tariff Item 23 of the Schedule which levied duty on "Vegetable, non-essential oils, all sorts, in or in relation to the manufacture of which any process is ordinarily carried on with the aid of power". This stand was negated by this Court holding that there could be no refined oil as known to the market without deodorisation. In other words, non-deodorised refined oil is not known to market whereas the 'refined oil' obtained by the respondent at an intermediate stage of production of vanaspati is not deodorised. The respondent, it was held, applied the process of deodorisation only after hydrogenation. The Court relied upon the specification by the Indian Standards Institution to hold that "without deodorisation, the oil is not 'refined oil' as is known to the consumers and the commercial community". Accordingly, it held that the 'refined oil' which was obtained by the respondent at an intermediate stage of production/manufacture of vanaspati was not liable to duty. The ratio of this judgment is that inasmuch as the 'refined oil' obtained by the respondent at an intermediate stage of production of vanaspati cannot be treated as 'refined oil' known to the market and consumers because no refined oil is ever marketed unless it is deodorised, it is not 'goods' for the purpose of the Act. It was found as a fact that the respondent did not deodorise the 'refined oil' at any stage; it applied the said process only after hydrogenation.

14. In the case of *Union Carbide India Ltd. v. Union of India*² the appellant-Company was engaged in the manufacture and sale of flashlights (torches). For that purpose, it used to purchase aluminium slugs and produced aluminium cans or torch bodies at its factory by a process of extrusion. The Superintendent of Central Excise called upon the appellant-company to submit a price-list in respect of the aluminium cans for the purposes of levying excise duty thereon. While complying with the said demand, the appellant protested that the said aluminium cans cannot be described as 'goods' for the purpose of levying excise duty inasmuch as they are not marketable and that they are prepared only for the purpose of flashlights manufactured by the appellant. It was also submitted that preparation of

aluminium cans out of aluminium slugs did not amount to manufacture and that aluminium cans are merely intermediate products in the manufacture of flashlights. The aluminium cans prepared by the appellant, it submitted, were manufactured by it entirely for its own purposes, viz., for the manufacture of flashlights. The aluminium cans at the point at which the excise duty was sought to be levied were in crude and elementary form incapable of being employed in that State as components in flashlights. The cans had sharp uneven edges and before they could be used as a component in making the flashlight, these cans had to undergo various processes such as trimming, threading and redrawing. After trimming, threading and redrawing, they were reeded, beaded and anodised or painted. It is at that point that they became distinct and complete components capable of being used as flashlight cans for housing battery cells and for having a bulb fitted thereto. On the said facts, it was held by this Court that the aluminium cans in their aforesaid elementary and unfinished form were not capable of sale to a consumer and hence not marketable - nor were they ever marketed. This Court accepted the affidavit filed by the appellant that the aluminium cans in that State are not known to the market because the Revenue could not produce any material to the contrary. The ratio of this decision is that the aluminium cans which were sought to be taxed were, in that State not marketable. They were not capable of being sold to a consumer nor were they ever sold in that State.

15. In the case of *Bhor Industries Ltd. v. CCE*³, the question that fell for consideration of this Court was whether the crude PVC films manufactured by the appellant therein were 'goods' within the meaning of S. 3. The crude PVC films represented an intermediate product used for captive consumption in manufacture of leather cloth, laminated jute mattings and PVC tapes. It was found by the appellate collector on the material produced by the appellants that crude PVC films were not marketable products. The Revenue could not produce any material establishing the contrary. On that basis it was held by this Court that the crude PVC films are not marketable and not being 'goods' known to market, they cannot be treated as 'goods' for the purposes of S. 3. It was observed that marketability is an essential ingredient in order to be dutiable under the Schedule to the Act. It was further observed that excise duty is leviable if the goods are capable of being sold, though its actual sale is not necessary.

16. In the case of *Union of India v. Delhi Cloth and General Mills Co. Ltd.*⁴ reliance whereupon has been heavily placed on behalf of the appellant-Company, question that had arisen was whether excise duty was leviable on calcium carbide that was manufactured by the assessee-company not for its marketing, but for captive consumption, i.e., the same used to be utilised further in the production of acetylene gas for being marketed. On these facts, it was held that excise duty was not leviable on the manufacture of calcium carbide which was manufactured only for the captive consumption as one of the raw materials for production of acetylene gas and the same was leviable on the end product, i.e., acetylene gas which was marketable. This decision cannot be of any avail to the appellant as the same is clearly distinguishable.

17. From a conspectus of the aforesaid decisions, it would be clear that for the purposes of levy of excise duty, the test to be applied is whether the goods manufactured are marketable or not. In the present case, the cigarette, which is the end product of tobacco, is fit for

consumption before the same is removed for test. Packing of the cigarette cannot be said to be incidental or ancillary to the manufacturing process, but the same may be incidental or ancillary to its sale only. In case it is laid down that packing of cigarette is incidental or ancillary to the completion of manufactured products, the same may result into evasion of excise duty as before packing the cigarettes the same may be regularly supplied to each and every employee for his consumption without payment of excise duty thereon. The definition of 'manufacture' under S. 2(f) very clearly includes process which is incidental or ancillary to the completion of manufactured product. Manufacture of cigarette is completed when the same emerges in the form of sticks of cigarettes which are sent to the laboratory for quality control test. Sticks of cigarettes can be consumed and manufacture of the end-product, i.e., cigarette, which is commercially known in the market as such, is completed before its removal for test and after testing only packing of the same, which is the requirement of Rule 93 of the Rules, is done. Thus, we hold that sticks of cigarette which are removed for the purpose of test in the quality control laboratory located within the factory premises of the appellant-Company are liable to excise duty.

18. Coming now to the second question, it may be stated that learned counsel appearing on behalf of the Revenue could not dispute the proposition that the quantity of cigarette sticks that is destroyed in the course of quality control test is not liable to excise duty. He, however, submitted that no evidence whatsoever was adduced on behalf of the appellant-Company either before the assessing authorities or the Tribunal to show that any cigarette stick was destroyed in the process of quality control test, much less cigarette sticks of any particular quantity inasmuch as, undisputedly, for major period no account at all was maintained and for some period, though account was maintained in relation to the quantity of cigarette sticks sent to the laboratory for testing, but no account was maintained as to how much quantity was destroyed during the process of testing. It was pointed out by learned Additional Solicitor General that though in the show cause notice the appellant-Company was specifically called upon to show cause for non-maintenance of account in relation to the sticks of cigarette sent for quality control test, but in spite of that it failed to produce any account whatsoever to show as to how much quantity of cigarette sticks was sent for quality control test during different periods, much less producing any account in relation to the destruction of the cigarette sticks during the course of testing. At this stage, Shri Ganesh submitted that the matter should be remitted either to the Tribunal or the assessing authority for affording opportunity to the appellant to produce the accounts and then record a finding as to how many cigarette sticks were destroyed during the course of testing. In our view, no useful purpose will be served by remitting the matter on this question, firstly, because even according to the show cause reply filed by the appellant-Company before the assessing authorities, it had not maintained any account in relation to the destruction of cigarette sticks during the course of quality control test and, secondly, no reason was assigned for not producing any account either before the assessing authority or before the Tribunal in spite of the fact that it was clearly stated in the show cause notice that the appellant-Company was not maintaining any such account. In view of the non-maintenance and non-production of accounts in relation to the destruction of cigarette sticks during the course of testing, we are of the opinion that excise duty was leviable on the entire stock of cigarette sticks sent to the laboratory for quality control test.

19. For the foregoing reasons, we do not find any merit in these appeals, which are accordingly dismissed, but in the facts and circumstances of the case, there shall be no order as to costs.

Appeals dismissed.

¹1963 *Supp (1) SCR* 586

²1986 (2) *SCC* 547

³(1989) 1 *SCC* 602

⁴1997 (92) *ELT* 315 (SC)