

SUPREME COURT OF INDIA

Commissioner, Central Excise, Chandigarh

Vs.

Kwality Ice Cream Co.

C.A.Nos.8456-8463 of 2002

(B.Sudershan Reddy and Surinder Singh Nijjar JJ.)

26.11.2010

JUDGMENT

B.Sudershan Reddy,J.

1. The short question that arises for our consideration in these appeals is whether M/s. Kwality Ice Cream Company on the one hand and Brooke Bond Lipton India Limited - (BBLIL) on the other (which later merged with Hindustan Lever Limited -HLL) are treated to be related persons in the matter of computing assessable value of ice cream manufactured by M/s. Kwality Ice Cream and as to whether duty should be demanded from M/s. Kwality Ice Cream on the basis of the price at which BBLIL sold the said product from its depot.

2. M/s. Kwality Ice Cream (respondent-assessee) is engaged in the manufacture of ice cream falling under the Schedule to the *Central Excise Tariff Act, 1985* (for short 'the Act'). It entered into an agreement for the sale of the entire production to BBLIL, which later merged with HLL, for marketing. It has entered into agreement with BBLIL for a period ending on March 21, 1997. Later an agreement was entered into with M/s. HLL with effect from March 22, 1997. The terms and conditions of this agreement are the same as those with BBLIL.

3. The contention raised by M/s. Kwality Ice Cream that the entire transaction between the parties covered by the agreement was on principal to principal basis and that the price was sole consideration for the sale of the goods was not accepted by the departmental authorities. The demand under show cause notices covering the period from February, 1996 to November, 1997 was confirmed by the Assistant Commissioner under Section 11 of the Central Excise Act, 1944. Appeals preferred by M/s. Kwality Ice Cream against the said order were rejected on the ground that the agreement between M/s. Kwality Ice Cream and BBLIL/HLL does not leave any scope but to indicate that M/s. Kwality Ice Cream has no autonomy to run its unit. Starting from the procurement/purchase of raw material to the manufacture of final product, all the activities of M/s. Kwality Ice Cream were fully controlled by BBLIL/HLL. The nature and type of machinery to be put in use was in terms of the directions of BBLIL/HLL. M/s. Kwality Ice Cream did not have any liberty to market its

goods. The appellate authority took the view that the transactions between the parties were not on principal to principal basis. Interest accrued on interest free deposit with M/s. Kwality Ice Cream, read with other terms and conditions of the agreement, reveal that it was clearly an extra commercial consideration.

4. M/s. Kwality Ice Cream preferred appeals challenging the order passed by the Commissioner before CEGAT, New Delhi, inter-alia, contending that the price of the product was not determined exclusively at the instance of BBLIL but was determined in terms of the formula given in Appendix 4 to the source agreement. The formula was an integral part of the source agreement according to which the price was fixed. There was even a provision for pricing after upgrading of the existing factories/manufacturing facilities or at the new factories/manufacturing location of M/s. Kwality Ice Cream.

5. The CEGAT after elaborate consideration of the matter found that the provisions contained in clause (9) read with Appendix 4 and 5 of the agreement between the parties clearly establish that the price was not being fixed by BBLIL exclusively but on the other hand the price was fixed on the basis of the formula agreed between the parties. The Tribunal concluded that the transaction between the parties was on principal to principal basis. The Tribunal accordingly held that M/s. Kwality Ice Cream and M/s. BBLIL/HLL are not 'related persons' and the transaction between them is one on principal to principal basis and the price was the sole consideration for the sale of the goods and assessable value cannot be computed on the basis of the price at which BBLIL sold the products from its depot. It is that order which is under challenge in these appeals preferred under Section 35-L of the Central Excise and Salt Act, 1944.

6. Learned counsel for the Department strenuously contended before us that the Tribunal committed an error in coming to the conclusion in characterizing the same as on principal to principal basis, and not as between related persons. The submission was that the nature and extent of control over the activities of M/s. Kwality Ice Cream and huge interest free deposits, complete control over price fixation mechanism unerringly point to the fact that the M/s. Kwality Ice Cream and HLL were 'related persons'. Learned counsel for the respondent - assessee submitted that the findings recorded by the Tribunal do not warrant any interference by this Court as the same were based on proper appreciation of the material available on record. It was submitted that the Tribunal merely applied the principle enunciated by this Court and came to the right conclusion that the parties are not to be treated as 'related persons' in the matter of computing assessable value of ice cream manufactured by M/s. Kwality Ice Cream. It was submitted that even on the facts pleaded by the Department there is no evidence of any mutuality of interest in the business of each other.

7. We have carefully considered the submissions made by the learned counsel in these appeals.

8. It becomes necessary to examine the ambit and scope of the term 'related persons' in order to gauge whether the relationship between M/s. Kwality Ice Cream and HLL can be brought

within its fold. A catena of cases have explored and expounded the concept of 'related persons' and the intricacies involved in invoking its application. We shall refer to some of those relevant cases in order to decide the points urged by the learned counsel for the Department but before we do so it is necessary to have a glance at the relevant provisions of the Act. Section 4 of the Act provides as under:

“SECTION 4. VALUATION OF EXCISABLE GOODS FOR PURPOSES OF CHARGING OF DUTY OF EXCISE.

(1) Where under this Act, the duty of excise is chargeable on any excisable goods with reference to value, such value shall, subject to the other provisions of this section, be deemed to be- (a) The normal price thereof, that is to say, the price at which such goods are ordinarily sold by the assessee to a buyer in the course of wholesale trade for delivery at the time and place of removal, where the buyer is not a related person and the price is the sole consideration for the sale:

Provided that -

(i) Where, in accordance with the normal practice of the wholesale trade in such goods, such goods are sold by the assessee at different prices to different classes of buyers (not being related persons) each such price shall, subject to the existence of the other circumstances specified in clause (a), be deemed to be the normal price of such goods in relation to each such class of buyers;

(ia) where the price at which such goods are ordinarily sold by the assessee is different for different places of removal, each such price shall, subject to the existence of other circumstances specified in clause (a), be deemed to be the normal price of such goods in relation to each such place of removal;

(ii) Where such goods are sold by the assessee in the course of wholesale trade for delivery at the time and place of removal at a price fixed under any law for the time being in force or at a price, being the maximum, fixed under any such law, then, notwithstanding anything contained in clause (iii) of this proviso, the price or the maximum price, as the case may be, so fixed, shall, in relation to the goods so sold, be deemed to be the normal price thereof;

(iii) Where the assessee so arranges that the goods are generally not sold by him in the course of wholesale trade except to or through a related person, the normal price of the goods sold by the assessee to or through such related person shall be deemed to be the price at which they are ordinarily sold by the related person in the course of wholesale trade at the time of removal, to dealers (not being related persons) or where such goods are not sold to such dealers, to dealers (being related persons), who sell such goods in retail;

(b) Where the normal price of such goods is not ascertainable for the reason, that such goods are not sold or for any other reason, the nearest ascertainable equivalent thereof determined in such manner as may be prescribed.

(2).....

(3).....

(4) For the purposes of this section,-

(a) "Assessee" means the person who is liable to pay the duty of excise under this Act and includes his agent;

(b)

(c) "Related person" means a person who is so associated with the assessee that they have interest, directly or indirectly, in the business of each other and includes a holding company, a subsidiary company, a relative and a distributor of the assessee, and any sub-distributor of such distributor.

Explanation : In this clause "holding company", "subsidiary company" and "relative" have the same meanings as in the *Companies Act, 1956.*"

9. According to clause (c) of sub-section (4) of Section 4 of the Act, `related person' means a person who is so associated with the assessee that they have interest, directly or indirectly, in the business of each other and includes a holding company, a subsidiary company etc. The explanation to Section 4 (4) (c) further provides that in this clause `holding company', `subsidiary company' and `relative' have the same meanings as in the Companies Act, 1956. It is in this background that the validity or otherwise of the Tribunal's order is required to be analyzed and judged.

10. In *Union of India vs. Bombay Tyre International Ltd.*¹, this Court examined the scheme of Section 4 (1) (a) before the Amendment Act, 1973 and also the position after the amendment. It was contended in that case before this Court that the definition of the expression "related person" was arbitrary and it included within its ambit a distributor of the assessee. This Court, however, held that in the definition of `related person' being a relative and a distributor could be legitimately read down and its validity upheld. The definition of `related person' should be so read, this Court emphasised, that the words "a relative and a distributor of the assessee" should be understood to mean a distributor who was a relative of the assessee. The Explanation to Section 4(4)(c) provides that the expression "relative" has the same meaning as in the Companies Act, 1956. The definition of "related person", as being "a person who is so associated with the assessee that they have interest, directly or indirectly, in the business of each other and includes a holding company, a subsidiary company ...", shows a sufficiently restricted basis for employing the legal fiction. It was

reiterated that it is well settled that in a suitable case the Court could lift the corporate veil where the companies share the relationship of a holding company and a subsidiary company and also pay regard to the economic realities behind the legal facade. This aspect was further examined by this Court in *Union of India Vs. ATIC Industries Ltd.*² This Court referred to the decision of *Bombay Tyre International Ltd.* (supra) and also referred to the first part of the definition 'related person' in clause (c) of Section 4.

“(4) which defines 'related person'. This Court observed that if the transactions between the manufacturer and his customers were on principal to principal basis and the whole sale price charged by the assessee to the customers was the sole consideration for the same and no extra commercial considerations entered in the determination of such a price, the customer cannot be held to be a 'related person' merely because he holds 50% share in the manufacturing company. It is held:

"It is not enough that the assessee has an interest, direct or indirect, in the business of the person alleged to be a related person nor is it enough that the person alleged to be a related person has an interest, direct or indirect, in the business of the assessee. It is essential to attract the applicability of the first part of the definition that the assessee and the person alleged to be a related person must have interest, direct or indirect, in the business of each other. Each of them must have a direct or indirect interest in the business of the other. The equality and degree of interest which each has in the business of the other may be different; the interest of one in the business of the other may be direct, while the interest of the latter in the business of the former may be indirect. That would not make any difference, so long as each has got some interest, direct or indirect, in the business of the other”

11. In *Union of India vs. Playworld Electronics Pvt. Ltd.*³, this Court took the view that merely because goods are produced with customer brand name and the entire production sold to the owner of the brand name, cannot be treated as a sale between 'related persons'. The case was that Playworld Electronics Pvt. Ltd. manufactured its products in the brand name of 'Bush' from the very beginning and was selling the same exclusively to M/s. Bush India Limited or its authorized dealers only. This Court took the view that the market value of the goods of Playworld Electronics Pvt. Ltd. was the price charged from M/s. Bush India Ltd. and not the market value at which price M/s. Bush India Ltd. sold to its wholesalers for the purpose of payment of excise duty.

12. We shall now notice the judgment upon which reliance has been placed by the learned counsel for the appellant in *Calcutta Chromotype Ltd. vs. Collector of Central Excise, Calcutta*⁴. The said decision refers the decision of this court in *Atic Industries Ltd.* (supra) and does not take any different opinion. The Court in the said decision also noticed the view expressed by this Court in *Collector of Central Excise, Madras vs. T.I. Millers Ltd., Madras and T.I. Diamond Chain, Madras*⁵, *Snow White Industrial Corporation vs. Collector of Central Excise*⁶. After the analysis of all the said decisions this Court held:

“If we examine the thrust of all the decisions, there is no bar on the authorities to lift the veil of a company, whether a manufacturer or a buyer, to see it was not wearing that mask of not being treated as related person when, in fact, both, the manufacturer and the buyer, are in fact the same persons. Under sub-section (1) of Section 4 of the Act, value of the excisable goods shall not be deemed to be normal price thereof, i.e., the price at which such goods are ordinarily sold by the assessee to a buyer in the course of wholesale trade for delivery at the time and place of removal, if the buyer is a related person and price is not the sole consideration for sale. As to who is a related person, we have to see its definition in Section 4(4)(c) of the Act. It is not only that both the manufacturer and the buyer are associated with each other for which corporate veil may be lifted to see who is behind it but also that they should have interest, directly or indirectly, in the business of each other. But once it is found that persons behind the manufacturer and the buyer are same, it is apparent that the buyer is associated with the manufacturer, i.e., the assessee and then regard being had to the common course of natural events, human conduct and public and private business it can be presumed that they have interest, directly or indirectly, in the business of each other (refer Section 114 of the Evidence Act). It is, however, difficult to lay down any broad principle to hold as to when the corporate veil should be lifted or if on doing that, it could be said that the assessee and the buyer are related persons. That will depend upon the facts and circumstances of each case and it will have to be seen who is calling the shots in both the assessee and the buyer. When it is the same person the authorities can certainly fall back on the third proviso to clause (a) of Section 4(1) of the Act, to arrive at the value of the excisable goods. It cannot be that when the same person incorporates two companies of which one is the manufacturer of excisable goods and the other is the buyer of those goods, the two companies being separate legal entities, the Excise authorities are barred from probing anything further to find out who is the person behind these two companies. It is difficult to accept such a narrow interpretation. True that shareholdings in a company can change but that is the very purpose to lift the veil to find out if the two companies are associated with each other. Law is specific that when duty of excise is chargeable on the goods with reference to its value then the normal price on which the goods are sold shall be deemed to be the value provided (1) the buyer is not a related person and (2) the price is the sole consideration. It is a deeming provision and the two conditions have to be satisfied for the case to fall under clause (a) of Section 4(1) keeping in view as to who is the related person within the meaning of clause (c) of Section 4(4) of the Act. Again if the price is not the sole consideration, then again clause (a) of Section 4(1) will not be applicable to arrive at the value of the excisable goods for the purpose of levy of duty of excise.”

13. In *Flash Laboratories Ltd. vs. Collector of Central Excise, New Delhi*⁷ upon which strong reliance has been placed by the learned counsel for the appellant, in our considered opinion, does not take any different view other than the one taken by this Court in *Bombay Tyre International Ltd. and ATIC Industries Ltd.* (supra). In that case the appellant-Company was a manufacturer of toothpaste ("Prudent") falling under Sub-Heading 3306.00 of the

Schedule to the Act. It had been selling its products to its holding Company, PP Ltd. as well as to PB Ltd. which was also a subsidiary Company of PP Ltd. The appellant had been paying duty at the price at which the goods were sold to the holding Company. Having regard to the fact that both appellant as well as PB Ltd. were subsidiary Companies of PP Ltd., this Court took the view that though the relationship between the appellant and PB Ltd. is indirect, they had mutual interest in the business of each other. The facts and circumstances of the case reveal that there is a mutuality of interest between the three Companies as 60% of the products of the appellants was sold to PP Ltd. and remaining 40% of the total products of toothpaste was being sold to PB Ltd. Moreover, it was found that PP Ltd. was incurring expenses for sales promotion and advertisement for the sale of the appellants' products namely "Prudent Toothpaste". It was under those circumstances it was held that the parties to the transactions were 'related persons'. The said decision in no manner supports the point urged by the learned counsel for the appellants.

14. In *CCE vs. Xerographic Ltd.*⁸, this Court reiterated the well settled principle and laid down the three conditions that are required to be satisfied before invoking the third proviso, namely, firstly, there should be mutuality of interest; secondly, that the alleged 'related person' should be related to the assessee as per definition of Section 4 (4) (c) given in the Act and thirdly, and importantly, that the price charged from the 'related persons' was not the normal price but the price lower than the normal price and because of extra-commercial considerations the price charged was less than the normal value.

15. On analysis of the decisions referred to herein above, it appears what is important is that each of the parties involved should have an interest, whether direct or indirect in the business of each other. The following are the relevant clauses of the agreement between M/s. Kwalitiy Ice Cream and BBLIL/HLL based on which and applying the principles referred to herein above, a view is required to be taken as to whether they are 'related persons'.

“6 (i) - Kwalitiy Ice Cream (K-North) agrees to exclusively source and produce products for BBLIL.

(i) (a) - The products will be manufactured and produced by K(North) in accordance with the specifications, particulars of which are set out in Appendix -2 of the Agreement which inter alia provides that reasons for change in raw material will be intimated by the party to BBLIL and approved list of suppliers of material will be intimated by BBLIL and K (North).”

16. It is based on these clauses, the Departmental authorities took the view that the terms and conditions of the agreement between the respondent and BBLIL/HLL have mutuality of interest and therefore, the transactions between them are not on a principal to principal basis. The Tribunal upon meticulous analysis of the terms and conditions of the agreement found that the price was being fixed on the basis of the formula agreed between the parties. Reliance was placed on sub-clause (iii) of Clause 6 which provides that pending commencement of production by JVC, M/s. Kwalitiy Ice Cream shall make necessary

investments for upgradation, modification or alteration in the existing factory/manufacturing facilities as per required by BBLIL subject to necessary approvals and pending such investments M/s. Kwaliti Ice Cream shall not be responsible for any deficiency. On M/s. Kwaliti Ice Cream making such investment for upgradation or modification, the pricing agreed upon is on a formula which has taken into consideration the investments made by M/s. Kwaliti Ice Cream for upgradation, modification. The Tribunal rightly arrived at the conclusion that pricing in terms of clause (6)(iii) would not lead to the conclusion that the transaction was not one between principal to principal.

17. The Tribunal while interpreting clause (6) (ii) found that M/s. Kwaliti Ice Cream, as contended by the Department, was not under the control of BBLIL/HLL as it was not under any obligation to shut down its unit or even move to some other location against its will as contended by the Department. The clause provides that an option was given to M/s. Kwaliti Ice Cream to accept the suggestion of BBLIL/HLL and to discontinue or close down its manufacturing facilities or not to accept the same since liberty was given to M/s. Kwaliti Ice Cream to intimate BBLIL/HLL about its view in the matter. There is nothing to show in that clause that BBLIL/HLL can compel M/s. Kwaliti Ice Cream to close down the factory or move it from its current location. The only affect of M/s. Kwaliti Ice Cream not accepting the suggestion is that BBLIL/HLL will be relieved of its obligations under the sourcing agreement. This clause merely indicates conditions on which the terms of sourcing agreement could be brought to an end.

18. The Tribunal also analyzed clause (6) (i) (c) of the sourcing agreement which inter alia provides that BBLIL/HLL would make interest free deposits of Rs. 2.75 crores to the units of M/s. Kwaliti Ice Cream. The Tribunal on fair analysis of the clause in the sourcing agreement held that the deposits from BBLIL/HLL were taken by M/s. Kwaliti Ice Cream as a matter of commercial expediency and as a trade practice required in the circumstances of the case. This was so because the amount due to M/s. Kwaliti Ice Cream as price of the Ice Cream manufactured for M/s. BBLIL is tied up for more than one month before payment is received by M/s. Kwaliti Ice Cream and goods were exclusively manufactured according to the specifications of BBLIL and even packing material required carrying their brand name, there was any amount of risk of goods being rejected by BBLIL for reasons other than quality and this was the commercial expediency for making such deposits.

19. What is of importance is certain interdependence and reciprocity beyond the relationship of either a distributor or manufacturer so as to consider as to whether the parties are 'related persons'. On the facts it is noticed, essentially the relationship between M/s. Kwaliti Ice Cream and BBLIL/HLL is one sided and the facts do not suggest that each one of them have interest direct or indirect, in the business of each other.

20. In *Supreme Washers Pvt. Ltd. vs. Commissioner of Central Excise, Pune*⁹, the Court had to consider and analyse the concept of mutual interest and it was found that there was common procurement of raw material, parties had common stock accounting and planning and interdependence in manufacturing operations. It was held that having common stock of

raw material and semi finished goods, having common use of machinery between the three units, having common marketing arrangements and free flow of finance between the three units cumulatively indicates interdependence of the three units with each other as also inter-relationship, cumulatively establishes the appellants inter relationships and interdependence with each other. No such interdependence is found in the instant case.

21. For the aforesaid reasons, we are of the considered opinion that the Tribunal did not commit any error in coming to the conclusion that M/s. Kwality Ice Cream and BBLIL are not `related persons'. The transaction between them is of the nature of principal to principal and the price was the sole consideration for the sale of goods. Therefore, the assessable value cannot be computed on the basis of the price at which BBLIL sold the product from its depot.

22. We, accordingly, find no merit in these appeals and they are accordingly dismissed.

¹ [1983 ELT 1896 SC]

² [1984 (17) ELT 323 SC = 1984 (3) SCR 930]

³ 1989 (41) ELT 368 SC

⁴ 1998 (99) ELT 202 (SC)

⁵ 1988 (35) E.L.T. 8 (SC)

⁶ 1989 (41) E.L.T. 360 (SC)]

⁷ 2003 (2) SCC 86

⁸ (2006) 9 SCC 556

⁹ (2003) 1 SCC 142