Chapter 3 : Valuation of excisable goods

During the course of this audit, we observed 25 cases of incorrect valuation of excisable goods with duty impact of ` 547.93 crore. These had not been detected by departmental compliance verification mechanisms prior to Central Excise Receipt Audit (CERA) pointing out the same. The Ministry/department agreed with our observations/took corrective action in 10 of these cases, involving duty of ` 238.83 crore and recovered ` 68.74 lakh in nine cases. A few of these cases are elucidated in the following paragraphs.

3.1 Central Excise liability in respect of clearance of goods to inter-connected undertakings

Section 4(1) of the Central Excise Act, 1944 provides, *inter alia*, that where under the Act, the duty of excise is chargeable on any excisable goods with reference to their value, then, on each removal of the goods, such value shall, in a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value. It adds that in any other case, the value shall be the value determined in such manner as may be prescribed.

Section 4(3)(b) also provides that persons shall be deemed to be "related" if -

(i) hey are inter-connected undertakings;

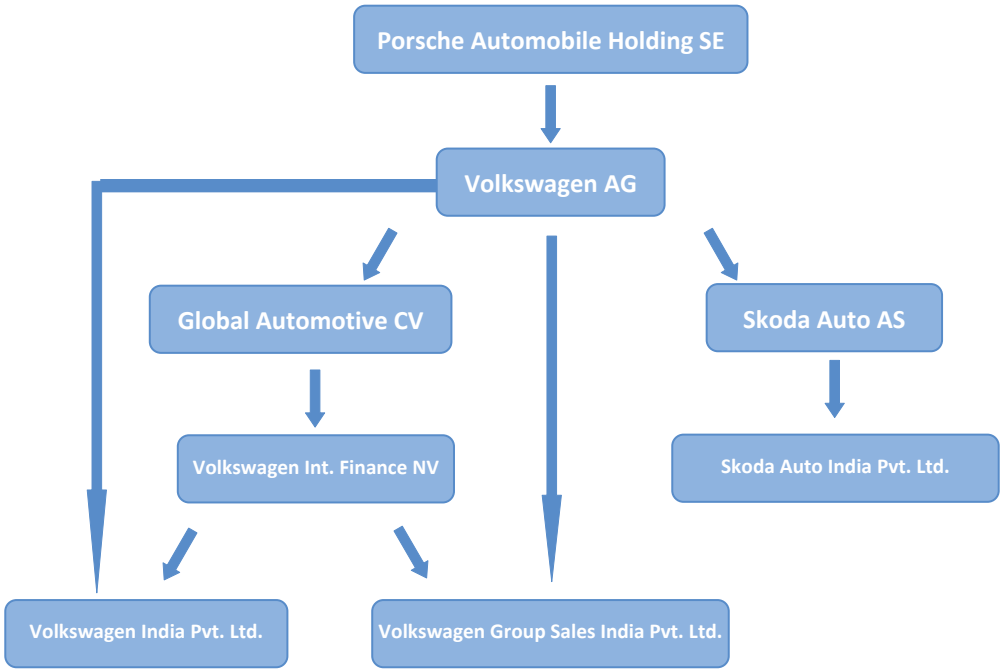
(ii) hey are relatives;

(iii) mongst them the buyer is a relative and a distributor of the assessee, or a sub-distributor of such distributor; or

(iv) hey are so associated that they have interest, directly or indirectly, in the business of each other.

Explanation below Section 4(3)(b) also details the circumstances in which two undertakings would be treated as 'inter-connected undertakings'.

3.1.1 Sub-clause (F) of Explanation cited above provides that if the undertakings are owned or controlled by the same person or by the same group, they would be inter-connected undertakings for the purposes of the Act. Further, vide Explanation V to Section 4, "group" includes, *inter alia*, two bodies corporate which exercise control, directly or indirectly over any body corporate.



During examination of records of Volkswagen India Pvt. Ltd. (VIPL), we observed that Volkswagen cars are manufactured in India by VIPL as well as by M/s Skoda Auto India Pvt. Ltd. (SAIPL). However, all Volkswagen cars are marketed in India through another undertaking viz. Volkswagen Group Sales India Pvt. Ltd. (VGSIPL). We also observed that both VIPL and VGSIPL are owned by two other foreign companies viz. Volkswagen AG and Volkswagen International Finance NV. M/s Volkswagen International Finance NV holds paid up shares of 23 per cent and over 99 per cent, respectively in M/s VIPL and M/s VGSIPL. The remaining shares in both companies are owned by Volkswagen AG. As M/s VIPL and M/s VGSIPL are owned and controlled by the same group, they are inter-connected undertakings vide sub-clause (F) of the cited Explanation, and hence related persons under Section 4 of the Act. Hence, the assessable value would be determined by the Rules prescribed, viz. the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.

Rule 10 of the above cited Rules envisages that when an assessee so arranges that the excisable goods are sold by him only to or through an inter-connected undertaking, the value of goods shall be determined as follows : -

(a) If the undertakings are so connected that they are also related in terms of sub-clause (ii) or (iii) or (iv) of clause (b) of sub-section (3) of Section 4 of the Act or the buyer is a holding company or subsidiary company of the assessee, then the value shall be determined in the manner prescribed in rule 9.

(b) in any other case, the value shall be determined as if they are not related persons for the purpose of sub-section (1) of Section 4.

Further, rule 9 envisages that where excisable goods are sold by an assessee only to or through a person who is related in the manner specified in either of sub-clauses (ii), (iii) or (iv) of clause (b) of sub-section (3) of Section 4 of the Act, the value of the goods shall be the normal transaction value at which these are sold by the related person at the time of removal to buyers (not being related person).

In this case, we observed that the seller and buyer are inter-connected undertakings. They could also be seen to fulfil sub-clause (iv) of Section 4 (3) viz. they are so associated that they have interest, directly or indirectly, in the business of each other. Even though the two companies do not hold shares in each other, VIPL depends totally on VGSIPL for the marketing of its cars. So too, VGSIPL's marketing activities would be dependent to a significant extent, on the cars manufactured and supplied to it by VIPL (its other sources are its other Group division companies SAIPL, Audi India and Porsche India). Hence, there is a mutuality of interest and hence, the value is to be determined by applying rule 9 above.

Therefore, the value for goods realised by M/s VGSIPL on sale to its customers would be the value for the purpose of assessable value of M/s VIPL. We observed from M/s VGSIPL's balance sheets for 2011-12 and 2012-13 that disclosure of related party transactions indicated purchase of goods manufactured by M/s VIPL. Comparing the figures relating to purchase of traded motorcars by VGSIPL *vis-a-vis* the value considered for the ER-1 returns, we saw that there was a difference of ` 647.71 crore which would be attributable to amounts such as warranty charges, VGSIPL margin etc. Since M/s VIPL and M/s VGSIPL are related companies, the above charges are to be included in calculating the assessable value for clearances made by M/s VIPL. Non-inclusion of the same resulted in short levy of duty of ` 182.71 crore.

We pointed this out in January 2014.

The Ministry replied (October 2014) that though M/s VIPL and M/s VGSIPL are interconnected undertakings, clearances by M/s VIPL would not be covered under rule 10 as M/s VIPL and M/s VGSIPL do not have a holding and subsidiary relationship. Further, DGCEI, Pune Regional Unit is already undertaking investigations in respect of the undervaluation of transaction value of vehicles manufactured by M/s VIPL in relation to sales to M/s VGSIPL, hence CERA observations are being included in the scope of DGCEI's investigations.

Audit opinion is that the undertakings are not only inter-connected but also satisfy the requirement of 'mutuality of interest in each other's business' under sub-clause (iv) of Section 4(3)(b).

It is also to pointed out that that neither the Act nor the Rules provide clarity on when undertakings would be termed as being so associated that they have interest, directly or indirectly, in the business of each other.

We also observe that by including an additional requirement of "holding and subsidiary relationship" between the two parties in addition to their being inter-connected undertakings, rule 10(a) has very significantly diluted the provision of Section 4 (1) of the Act. Audit opines that the rule has gone beyond the scope envisaged in the substantive statutory provisions. What the statute intended was that in any case where the parties are deemed to be related including where the parties are "inter-connected undertakings", the value would be determined as prescribed. There was no exception made by Parliament that as regards inter-connected undertakings not fulfilling an additional criterion, such as holding-subsidiary relationship, assessable value would be the transaction value/ normal transaction value. In fact, the impact of rule 10(a) is clearly seen in the fact that it totally nullifies/makes irrelevant the existence of Section 4(3)(b)(i) and the detailed definition of inter-connected undertakings in the Explanation under Section 4(3) of the Act. Rule 10 requires that either the two parties should share holding company-subsidiary company relationship or they should meet the criterion as per one of the other three sub-clauses under Section 4(3)(b).

We emphasise that absence of clear provisions concerning what would constitute mutuality of interest for the purposes of sub-clause (iv) of Section 4(3)(b) coupled with the introduction of the additional requirement of "holding and subsidiary relationship" may in fact have resulted in providing a means for several inter-connected undertakings to pay tax on lower value than envisaged by Parliament.

It is also to be mentioned here that until July 2000 when the amended Section 4 was introduced, "related person" meant a person 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. Thus, rule 10 in fact has had the effect of restoring/ reintroducing the previous definition of "related person".

Recommendation No. 5

(a) The Ministry should review rule 10 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, as it imposes an additional requirement of "holding and subsidiary relationship" not envisaged by the Act.

(b) Clear provisions need to be introduced indicating what would constitute "mutuality of interest in each other's business" for the purposes of clause (iv) of Section 4 (3) (b) of the Act just as the expressions "inter-connected undertakings", "group", "related persons", "under the same management" have been explained in the law.

3.1.2 Sub-clause (G) of Explanation below Section 4 (3) (b) envisages that if one undertaking is connected with another undertaking either directly or through any number of undertakings which are inter-connected undertakings, then these two undertakings would also be inter-connected undertakings for the purposes of Section 4 (3)(b)(i) of the Act.

During examination of records of M/s SAIPL, in Aurangabad Commissionerate, we observed that the company manufactures passenger cars which were sold exclusively through M/s VGSIPL. M/s SAIPL is a subsidiary of M/s Skoda A.S., in turn a subsidiary of M/s Volkswagen AG. The ultimate holding company of M/s Volkswagen AG is M/s Porsche Automobile Holding SE, another foreign company (with over 50 per cent shares). M/s Porsche Automobile Holding SE is also the ultimate holding company for M/s Volkswagen International Finance NV. Besides, M/s Volkswagen AG holds 99.9 per cent shares in Global Automotive CV which holds 100 per cent shares of Volkswagen International Finance NV and who in turn holds over 99 per cent shares in M/s VGSIPL.

Thus, by sub-clause (G) of Explanation below Section 4 (3) (b), M/s SAIPL and M/s VGSIPL would also be inter-connected companies as the former is connected to the latter indirectly through other inter-connected undertakings.

Therefore, for the purpose of Section 4 of the Act, the value for goods realised by M/s VGSIPL shall be value of AUDI and Volkswagen cars manufactured by M/s SAIPL. We observed that M/s VGSIPL included a

margin of 9.5 per cent in retail sale value of each car in respect of Audi cars and 6 per cent in respect of Volkswagen cars sold by it through its dealers. The non-inclusion of the above margin money in the assessable value resulted in short levy of duty of ` 121.45 crore.

We pointed this out in February 2014.

While accepting the contention that the two undertakings are inter-connected undertakings, the Ministry added (October 2014) that rule 10 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 is not applicable as none of the four conditions in rule 10(a) is satisfied in this case.

It is however reiterated that M/s SAIPL and M/s VGSIPL are inter-connected undertakings as explained above by sub-clause (G) of Explanation below Section 4(3)(b). Further, rule 10 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 would be applicable on grounds similar to those discussed in Paragraph 3.1.1.

3.2 Non-payment of duty on price settlement

Explanation to Section 4 of the Central Excise Act, 1944 envisages, *inter alia,* that the price-cum-duty of the excisable goods sold by an assessee shall include the money value of additional consideration, if any, that flows directly or indirectly from the buyer to the assessee in connection with the sale of such goods.

Test check of records of M/s Fiat India Automobiles Ltd., in Pune-III Commissionerate, revealed that the assessee had manufactured 'Manza' brand of cars for M/s Tata Motors Ltd. During the months of May and June 2012, the assessee had raised debit notes on M/s Tata Motors Ltd. towards price settlement of the above models for the years 2010-11 and 2011-12. Non-inclusion of this debit note amount of `93.54 crore towards the transaction value had resulted in short payment of duty of ` 21.44 crore.

We pointed this out in September 2013.

The Ministry intimated (October 2014) that DGCEI, Mumbai had undertaken investigations on broader valuation issues on the basis of incriminating documents seized in March 2013. A show cause notice was issued for ` 335.33 crore in June 2014 covering the period 2009-14 and the said demand of duty includes the additional consideration by way of debit notes pointed out by CERA.

3.3 Non-inclusion of additional consideration

Section 4 (1) (a) of the Central Excise Act, 1944 stipulates that when excise duty is chargeable on any excisable goods with reference to its value, then such value shall be the 'transaction value' including the additional consideration, if any, flowing directly or indirectly from the buyer to the assessee in connection with the sale of such goods. Rule 6 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, stipulates that in cases where price is not the sole consideration, the assessable value shall be based on the aggregate of the price and money value of the additional consideration flowing directly or 'indirectly' from the buyer to the assessee. In M/s Super Synotex (India) Ltd.[16] the Honourable Supreme Court held on 28 February 2014 that unless the sales tax is actually paid to the Sales Tax Department of the State Government, no benefit towards excise duty can be given under the concept of 'transaction value'.

3.3.1 Examination of records of M/s Bajaj Auto Ltd. in Mumbai-LTU Commissionerate revealed that the assessee had received an amount of ` 826.82 crore and ` 68.95 crore during 2010-11 and 2012-13 respectively on account of deferred sales tax benefits. As per provisions mentioned above, Sales Tax amount so collected but not paid to the Government was to be taken into consideration for arriving at the assessable value. Non-inclusion of the same resulted in short levy of duty of ` 103.02 crore.

We pointed this out in July 2013.

The Ministry informed (October 2014) that in the light of the Supreme Court decision and based on departmental instructions dated 17 September 2014, show cause notice is under preparation for issue.

3.3.2 Similarly, M/s FIAT (I) Automobiles Pvt. Ltd., in Pune-III Commissionerate, had received ` 841.98 crore during 2010-11 to 2012-13 towards deferred sales tax benefits which resulted in short levy of duty of ` 89.72 crore.

We pointed this out in September 2013.

The Ministry intimated (October 2014) that show cause notice for ` 238.14 crore for the period from May 2009 to June 2014 was issued in June 2014.

3.4 Goods cleared to sister concerns

Section 4 of the Central Excise Act, 1944 read with rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 stipulates

[16] 2014 (301) ELT 273 (SC)

that where excisable goods are used for consumption by the assessee or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods. Board clarified vide its Circular dated 13 February 2003 that the cost of production of captively consumed goods will henceforth be done strictly in accordance with Cost Accounting Standard-4 (CAS-4).

3.4.1 We observed from the records of M/s Bosch Chassis Systems India Ltd., in Pune-I Commissionerate, that the assessee had cleared the goods to its sister units situated at Manesar, Sitarganj and Jalgaon during 2011-12 and 2012-13. Examination of Central Excise invoices revealed that the assessee had not paid duty as per CAS-4 valuation for the period from January 2012 to July 2012. This resulted in short payment of duty of ` 15.30 lakh (excluding interest). Differential duty would also be payable for the period from January 2013 to March 2013 for which CAS-4 valuation was yet to be finalised for this period.

We pointed this out in January 2014.

Admitting the audit observation, the Ministry stated (October 2014) that the assessee has paid duty and interest of ` 46.04 lakh during February and March 2014.

3.4.2 In 11 cases of other assessees under four Commissionerates, excisable goods were cleared to their sister units during 2010-11 to 2012-13. Examination of records revealed that CAS-4 was not prepared/ updated by the units. Hence, Audit could not quantify the short payment of duty.

We pointed this out between May 2013 and March 2014.

The department accepted the observations (May-June 2014) and intimated recovery of ` 19.83 lakh in six cases.

We await the Ministry's response (October 2014).

3.5 Undervaluation of DEMO cars

As per Board's circular dated 1 April 2003, the central excise duty payable on demo cars would be the same as that paid on similar normal cars.

M/s Hindustan Motors India Ltd (HMIL) in Chennai II Commissionerate are engaged in the manufacture of passenger cars falling under Chapter 87. During the scrutiny of invoices and list price of cars, we observed that the assessee had cleared the cars to their dealers for DEMO purposes at lesser value than the normal value. Non-adoption of normal value of cars for demo

cars by HMIL resulted in undervaluation of ` 28.92 lakh during the year 2011-12 and consequent short payment of duty of ` 6.89 lakh.

We pointed this out in July 2013.

We await the Ministry's reply (October 2014).