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EMPIRE VS UJAGAR = S. KUMAR



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If we identify top ten issues in Central Excise, which are highly litigation prone, "Job work" is sure to find its berth therein. In fact, in one of our earlier articles, we even requested the Government to frame "Central Excise (Job Work) Rules"!

Though, not as famous as the Ujagar series, the decision of the Hon'ble Apex Court in the case of Empire Industries {1985 (20) ELT 179 SC}, can be considered as the forerunner on the subject of job work valuation. The Hon'ble Apex Court has emphatically held that the job worker – processor cannot pay duty on his processing charges alone, but on the selling price of his customer/principal.

The series of decisions in the Ujagar Prints case is the second innings, where ultimately the job workers held the sway.

When the issue of job work valuation once again reached another three member bench of the Hon'ble Supreme Court in Ujagar Prints case – {1987 (27) ELT 567 SC} (Ujagar I), the Bench felt that it would be appropriate, only if duty is charged on job worker on the value of materials supplied and his conversion charges and the profit of the customer should not have been taken into account. However, in view of the contra decision by a co-ordinate bench in Empire Industries case, the Bench referred the issue to a 5 member bench. The decision of this 5 member bench is reported in 1998 (3) ELT 535 SC. Though the decision upheld the view in Empire Industries case that duty cannot be charged on the processing charges alone, there was some lack of clarity as to what would then be the assessable value, between the two, viz., (a) Intrinsic value of the processed goods i.e. landed cost of raw materials plus the labour charges of job workers; or (b) the price at which such goods are sold for the first time in the wholesale market. The Hon'ble Apex Court was once again called upon to clarify the decision, which it did in 1988 (39) ELT 493 SC. It was clarified that the assessable value of the goods manufactured on job work basis, shall be based on the landed cost of raw materials plus the conversion charges (which also includes the profit of the job worker) and not the ultimate selling price of the customer!

A landmark decision indeed, which led to the growth of population of a unique community, viz., job workers. Many sectors have started flouting job workers to get the products manufactured for them and avoided payment of duty on the selling price. There was much a slip between the cup and the lip for the Government, as the gulf between the assessable value under Ujagar Mode and the ultimate selling price, was wider than that of the English canal ([We have to indicate something, which is known for its width](#)).

Battered revenue was biting its nails. Litigation followed, alleging the independence of job workers. Issues such as, job worker being dummy of the principal, job worker being a hired laborer of the principal, arms length transactions etc. engaged the attention of all judicial fora. Over a period, the players of the game were so desperate to usurp to the Ujagar bounty and began to set up "job work units" which are closely related to the principal unit. Even then, the judicial forums were holding that the time tested principle enunciated in Ujagar case is beyond any sentiments of relationship.

Alas. Now the circle has come a full round. In its recent judgement in the case of CCE VS S. Kumar Limited {2005 (--) ELT ___ SC}, the Hon'ble Supreme court has written an important chapter in job work valuation. It has now been held by the Hon'ble Apex Court that, if the job worker is "related" to the customer/principal, the principles of Ujagar Prints would not apply and the valuation has to be done with reference to the selling price of the customer, thus giving partial life to the Empire! As the issue of job worker being related to the principal was never the subject matter before the Hon'ble Apex Court in Ujagar case, no impropriety can be complained that the present two member bench of the Hon'ble Apex Court has not followed the five member decision in Ujagar Prints case.

In the application of the present judgement, we foresee the following issues.

No doubt, the Apex Court has held that if the job worker is related to the principal, the principal's sales price has to be considered as the assessable value in the hands of the job worker. But a careful reading of the facts of the S.Kumar's case, would reveal that all the hope is still not lost and still there is a ray of hope.

Interesting?

The subject matter of the present decision of the Apex Court is the Tribunal's decision reported in 2000 (117) ELT 439. The following observation from the judgement is very much relevant.

The demand made in the order is on the basis that several firms constituted the S. Kumars group and these units being either related to S. Kumars or being intermediary/dummy set up by the group, the transactions among these units cannot be treated as independent commercial transactions and the **prices charged among them** cannot constitute the basis for levy of Central Excise duty.

The following extract from para 2 from the Apex Court decision is also relevant.

The basis of the demand against the respondents was that they were all firms and companies having a common management and control with **some of them selling grey fabric to the respondent No.1 which, after processing the fabrics, sold the same to some of the other respondents.** The latter ultimately sold the processed fabrics to independent dealers.

From the above, it may be observed that the transaction in this case was a sale of grey fabric by the principal to the job worker (who are all described as S.Kumar) and re-sale of processed fabrics by the job worker to other units of the principal. In such circumstances, the proper course for valuation is under Rule 7 of the erstwhile Central Excise Valuation Rules, 1975. When the goods are sold by an assessee to a related person, as per the said rule, the assessable value shall be the price at which the related person sells the goods. When the department thus proceeded, the assessee took the plea that the transaction was under job work mode and the principles under Ujagar decision shall be applied and the same was also upheld by the Tribunal. Upon appeal, the Hon'ble Supreme Court has held that the Ujagar principles are not at all applicable to the present case. As the transaction is by way of sale, only the provisions of Rule 7 of the Valuation Rules, 1975 would apply and not Ujagar Prints. As such, it can be safely concluded that the present decision, which has been rendered in the context of sale by the principal to the alleged job worker and resale by the job worker, cannot be applied to a case, where the transaction between the principal and job worker, is purely on job work basis i.e on payment of conversion charges. Is it not?

There is another dangerous dimension to the present decision, as explained below:

As per section 4 (1) (a), the transaction of value shall be the assessable value, if the following conditions are satisfied.

- ⌚ There is a sale.
- ⌚ Delivery at the time and place of removal.
- ⌚ Assessee and the buyer are not related.
- ⌚ Price is the sole consideration for sale.

If any of the condition are not satisfied, as per section 4 (1) (b), recourse has to be made to the Central Excise Valuation Rules, 2000. The different rules of valuation provide for different contingencies. For

brevity, let us not go into the details, for the present purpose. As only Rule 9 and 10 of the Valuation Rules, deal with the “related” persons, let us restrict to address only them.

According to Rule 9 of the Valuation Rules, if the assessee **sells** the goods to or through the following persons, viz,

- a. Relatives (applicable for individuals).
- b. Relative and distributor or sub-distributor of such relative distributor.
- c. Persons / entities having mutuality of interest.

the assessable value shall be the transaction value at which the goods are subsequently sold by these persons to non related buyers.

As per Rule 10 of the Valuation Rules, if the assessee **sells** the goods to interconnected undertakings, the price at which the goods are subsequently sold by the inter-connected undertakings to non related buyers, would be the assessable value, **only if** the two inter-connected undertakings (assessee – seller and buying company) are either:

- ⌚ Relatives; or
- ⌚ Relative and distributor or sub-distributor of such relative distributor; or
- ⌚ Having mutuality of interest; or
- ⌚ Buying company is a holding or subsidiary company of the assessee.

In other words, if none of these additional conditions are satisfied, even if the buying company is an inter-connected undertaking to the assessee, the transaction value between the assessee and the buying company would be the assessable value. In other words, if these additional conditions are not satisfied, the inter-connected undertaking would not be considered as being “related” to the assessee at all.

The definition of “inter-connected undertaking” is borrowed from the provisions of MRTP Act, which is sweeping in nature. As per Sec 2 (g) of the MRTP Act, even if one partner is common, then they are inter- connected undertakings. As per Sec 4 (1) (c) of the Central Excise Act, such “inter-connected undertakings” are deemed to be “related” persons. And that is the reason why Rule 10, apart from being an “interconnected undertaking, has included the above stated additional conditions, to adopt the related buyer’s value.

But, according to the present decision of the Hon’ble Apex Court, the department may argue that the Ujagar mode of valuation would not be applicable, if the job worker and the principal are related – simpliciter. As Rule 9 and 10 of the Valuation Rules are not applicable to the Job work valuation, which is done only under the residuary provisions, if the job worker and the principal are mere “inter-connected undertakings” the vice of the present decision would be attracted. The definition of inter-connected undertaking being so exhaustive, the recent decision will have far reaching implications. Hard days ahead for the job working community.

