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Valuation under Central Excise – Related party transaction

1. Valuation under Central Excise is in terms of sections 3, 4, 4A of the Central Excise Act, 1944 (“the Act”). Section 3(2) of the Act empowers the Central Government to fix the tariff value in respect of goods, section 4A of the Act provides that value will be the Maximum Retail Price (as reduced by the permissible abatement) and section 4 of the Act provides that the value will be the transaction value i.e. the value at which the goods are sold for delivery at the time and place of removal where the assessee and the buyer are not related and price is sole consideration for the sale. Where valuation is either under section 3 (2) or section 4A of the Act, provisions of section 4 of the Act are not applicable. The concept of related person in valuation arises only in case of section 4 of the Act.

2. When valuation is under section 4 of the Act, then on each removal of the goods, such value shall:-

- (a) in case where goods are sold by the assessee for delivery at the time and place of removal, the assessee and buyer of the goods are not related and price is the sole consideration for the sale, be the transaction value;
- (b) in any other case, including the case where the goods are not sold, be the value

determined in such manner as may be prescribed.

Therefore, under section 4 of the Act, central Excise duty is payable on the “transaction value” which is to be determined on each removal of the goods. However, such “transaction value” cannot be made the basis for valuation under section 4 of the Act if:

- there is no sale of goods at the time and place of removal;
- the assessee and the buyer of the goods are related persons;
- the price is not the sole consideration for sale

In all the above three scenarios, valuation has to be determined in terms of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 (hereinafter referred to as the “Valuation Rules, 2000”). This article examines valuation under section 4 of the Act when the assessee and the buyer are related, due to which the transaction value is not acceptable.

3. Section 4 of the Act itself provides when the assessee and the buyer shall be termed as related. As per section 4 (3)(b) of the Act persons shall be deemed to be related if:

- (i) they are inter-connected undertakings; or
- (ii) they are relatives; or

- (iii) amongst them the buyer is a relative and a distributor of the assessee, or a sub-distributor of such distributor or
- (iv) they are so associated that they have interest, directly or indirectly, in the business of each other.

Inter-connected undertakings have been defined to mean inter-connected undertakings as defined under the erstwhile Monopolies & Restrictive Trade Practices Act, 1969. Relatives have been given the meaning assigned to it in section 2(41) of the Companies Act, 1956.

4. The Central Government has issued the Valuation Rules, 2000 which contain 11 rules and most of the rules deal with valuation vis-à-vis a particular scenario. For instance, rule 5 provides for valuation when the goods are sold for delivery at a place other than the place of removal, rule 6 provides for valuation when price is not the sole consideration for sale, rule 7 provides for valuation when the goods are not sold at the factory gate but are transferred to a depot and so on. Rule 9 and Rule 10 of the Valuation Rules, 2000 deal with valuation vis-à-vis related person and read as follows:

“ Rule 9

When the assessee so arranges that the excisable goods are not sold by an assessee except 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); or where such goods are not sold to such buyers, to buyers (being related person), who sells such goods in retail:

Provided that in a case where the related person does not sell the goods but uses or consumes such goods in the production or manufacture of articles, the value shall be determined in the manner specified in rule 8.

Rule 10

When the assessee so arranges that the excisable goods are not sold by him except to or through an inter-connected undertaking, the value of goods shall be determined in the following manner, namely:

- (a) *If the undertakings are so connected that they are also related in terms of sub-clause sub-clauses (ii), (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 the rule 9*

Explanation: In this clause “holding company” and “subsidiary company” shall have the same meaning as defined in the Companies Act, 1956.

- (b) *In any other case, the value shall be determined as if they are not related persons for the purposes of sub-section (1) of section 4.”*

emphasis supplied

5. From the above, it is clear that there are two categories of related persons and for each category there is different rule applicable to arrive at the assessable value. The first category covers persons who are related because of being:

- a. a relative;;
- b. relative and distributor of the assessee or sub-distributor of such distributor or
- c. so associated with the assessee that both of them have interest, directly or indirectly in the business of each other.

Rule 9 of the Valuation Rules, 2000 applies to this category and value for this category is the normal transaction value i.e. the transaction value at which the highest aggregate quantities of goods are sold by the related party at the time of removal by the assessee.

The second category applies to inter-connected undertakings as defined under the erstwhile MRTP Act, 1969. Rule 10 of the Valuation Rules

applies to this category and this rule has been diluted inasmuch as it requires that apart from being inter-connected undertakings the parties should also be related by being either relatives or the buyer is a relative and a distributor of the assessee or a sub-distributor of such distributor or they are so associated that they have interest, directly or indirectly, in the business of each other. Therefore, if both the criteria are met then valuation is under rule 10 which provides that value shall then be computed in terms of rule 9 of the Valuation Rules, 2000.

6. It has however to be noted that even though the assessee and the buyer are related in terms of section 4 of the Act yet valuation under rule 9 or rule 10 of the Valuation Rules, 2000 will take place only when the assessee so arranges that the excisable goods are not sold by the assessee except to or through the related person. In other words, only when the assessee sells the entire production to or through a related person, valuation will be under rule 9 or rule 10, as the case may be, of the Valuation Rules, 2000. The Tribunal in the case of *Jay Formulations Ltd. vs. CCE reported in 2010 (261) ELT 641* had an occasion to deal with an issue regarding applicability of rule 9 of the Valuation Rules, 2000 when the entire production was not sold to or through a related person and the Tribunal held that rule 9 of the Valuation Rules, 2000 is not attracted.

7. The issue which requires examination is – if goods are sold to a related party and valuation is not under rule 9/rule 10 of the Valuation Rules, 2000 because of the fact that the entire sales are not to or through the related person, how are the goods to be valued?

8. It is but obvious that valuation cannot be under section 4(1)(a) of the Act i.e. the value cannot be the transaction value since the assessee and buyer are related person. In such cases, valuation will be under rule 4 of the Valuation Rules, 2000 which provides that the value shall be the comparable value subject to necessary adjustments. Rule 4 of the Valuation Rules, 2000 reads as follows:

“Rule 4

The value of the excisable goods shall be based on the value of such goods sold by the assessee for delivery at any other time nearest to the time of the removal of the goods under assessment subject, if necessary, to such adjustment on account of the difference in the dates of delivery of such goods and of the excisable goods under assessment as may appear reasonable.”

9. Therefore, when the sale is to a related party and valuation is not permissible under rule 9 or 10 of the Valuation Rules, 2000 value in respect of sales made to independent buyers at the time nearest to the time of removal will be taken as the value subject to adjustment as provided for under rule 4 of the Valuation Rules, 2000. The Tribunal in the case of *Balaji Electro Steel Ltd. vs. CCE reported 2007 (219) ELT 563* dealt with valuation of captively consumed goods when there is an independent sale price available. Though rule 8 of the Valuation Rules, 2000 specifically deals with captive consumption valuation, the Tribunal held that since the entire production is not captively consumed, rule 8 is not applicable and value will be the comparable value as provided for under rule 4 of the Valuation Rules, 2000. The ratio of this decision will apply when sale is to a related buyer but the entire sales are not to or through a related buyer due to which rule 9/rule 10 of the Valuation Rules, 2000 will not apply and valuation will have to be under rule 4 of the Valuation Rules, 2000 i.e. the value adopted in respect of independent sale transaction to an unrelated buyer. Though decision given in Stay Application is not a binding precedent, it is worth noting that the Tribunal in the case of *Exide Industries Ltd. vs. CCE reported in 2008 (232) ELT 365* granted an unconditional stay where the assessee in respect of sales made to related parties had adopted the value under rule 4 which was the sale price to unrelated buyer on the ground that the entire quantity was not sold to or through the related person and hence rule 9/rule 10 of the Valuation Rules, 2000 have no

application. However the Central Board of Excise and Customs (“the CBEC”) has taken a contrary view in this matter. The CBEC has issued a clarification *vide* Circular No. 643/34/2002-CE dated July 1, 2002, to the effect that when there is a situation where sale is made to a related person and partly to unrelated person, then in respect of valuation of goods sold to related buyers, valuation will have to be under rule 11 of the Valuation Rules read with rule 9 or rule 10.

10. Another important aspect in related party valuation is meaning of the term “interest, directly or indirectly, in the business of each other”. Even though section 4 of the Act dealing with valuation has undergone changes, this concept of persons being related as they have an interest, directly or indirectly, in the business of each other has always been present. The Courts time and again have analysed when it can be said that the assessee and the buyer have interest, directly or indirectly, in the business of each other. The Supreme Court way back in 1984 in the case of *Atic Industries Ltd. reported in 17 ELT 323* held that the requirement is that the persons have to be so associated that they must have interest, directly or indirectly, in the business of each other and it is not enough that the assessee has an interest, directly or indirectly, 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 any interest, directly or indirectly, in the business of the assessee. The Supreme Court held that it is essential that the assessee and the person alleged to be a related person must have interest, direct or indirect, in the business of each other. It was held that the equality and the degree of interest which each has in the business of other may be different and will depend on the facts of each case. In this case, the Supreme Court held that because 50% shares of the assessee company was held by the buyer company, it could be said that the buyer company was having an interest in the assessee company as shareholder but it cannot be said that assessee company has any interest,

direct or indirect, in the business carried on by one of its shareholders. The Supreme Court held that in the absence of mutuality of interest of each other, they cannot be termed as related.

11. Another decision of the Supreme Court in the case of *Calcutta Chromotype reported in 1998 (99) ELT 202* is relevant for the purposes of valuation with respect to related person. In this case while deciding whether parties are related or not, the Supreme Court held that under the Act, there is no bar on the authorities to lift the veil of the company, whether a manufacturer or 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 the same persons. The Supreme Court held that once it is found that the person behind the manufacturer and buyer are same, it is apparent that the buyer is associated with the manufacturer and then regard being to the common course of natural events, human conduct, public and private business it can be presumed that they have interest, directly or indirectly, in the business of each other. As to when the veil should be lifted depends on the circumstances of each case.

12. The issue as to whether persons are related or otherwise has been the subject matter of ongoing dispute between the department and the assessee. Few landmark cases on related party transaction are cited below where depending on the facts of the case, the Supreme Court decided whether they are related or otherwise:

Flash Laboratories vs. CCE (Supreme Court) reported in 2003 (151) ELT 241

The assessee was selling 60% of its products to its holding company “PPL” which had another subsidiary company “PBL”. The assessee sold remaining 40% to PBL. PPL was incurring expenses for advertisement and sales promotion for sale of the assessee’s products. In these facts,

the Supreme Court held that the relationship between the assessee and PBL though indirect, they have mutuality of interest in the business of each other and hence they are related persons for the purpose of section 4 of the Act.

CCE vs. I.T.E.C. (Pvt.) Ltd. (Supreme Court) reported in 2002 (145) ELT 280

There were common directors between two units which were relatives of one another. Family concerns managed both the companies and benefits were shared by members of one and the same family. The assessee itself filed price list in Part IV meant for related persons. In these facts, the Supreme Court held that mutuality of interest between two parties is established and they have to be treated as related person.

UOI vs. Playworld Electronics Pvt. Ltd. (Supreme Court) reported in 1989 (41) ELT 368

Merely because goods are produced with customer's brand name and the entire production is sold to customer, sales cannot be treated as sales to related person.

Alembic Glass Industries vs. CCE (Supreme Court) reported in 2002 143 ELT 244

The assessee and the buyer held some shares in each other and had common Chairman and three directors. The Supreme Court held that shareholders of the public limited company do not, by reason only of their shareholding, have interest in the business of the company. Further, the court held that the fact that the two public limited companies have common directors does not mean that they have common interest. It was held that they were not related.

13. To summarise, in respect of valuation under section 4 of the Act vis-a-vis related person:

- Transaction value under section 4(1)(a) of the Act is not applicable when sale is to a related person;
- Rule 9 and Rule 10 of the Valuation Rules, 2000 deal with valuation in respect of sales to or through a related person;
- Rule 9 / Rule 10 of the Valuation Rules, 2000 apply only when the entire sale is to or through a related person. When the entire sale is not to or through a related person, rule 9/rule 10 of the Valuation Rules, 2000 have no application. In such a scenario, valuation will be under rule 4 of the Valuation Rules, 2000 i.e. the comparable price subject to adjustments. The CBEC has taken a contrary view as reflected in Circular No. 643/34/2002-CE dated July 1, 2002.
- There are two categories of related persons under section 4 of the Act. First category covers all persons other than inter-connected undertakings and in this category, valuation is under rule 9 i.e. the normal transaction value at which the related party sells the goods (refer paragraph 5 for meaning of "normal transaction value"). The second category covers only inter-connected undertakings and rule 10 deals with this category. In respect of inter-connected undertakings apart being inter-connected undertakings they also have to satisfy the condition of having an interest directly or indirectly in the business of each other so as to be covered by rule 10 of the Valuation Rules. If both the conditions are satisfied in the second category, then the valuation is as per rule 9 i.e. the normal transaction value at which the related party sells the goods.

