CASE NO.:
Appeal (civil) 275-276 of 2001

PETITIONER:
O.K. Play (India) Ltd.

RESPONDENT:
Commissioner of Central Excise-II, New Delhi

DATE OF JUDGMENT: 04/02/2005

BENCH:
S.N. Variava & Dr. AR. Lakshmanan & S.H. Kapadia

JUDGMENT:
JUDGMENT

KAPADIA, J.

The short question which arises for determination in these civil appeals filed under section 35L (b) of the Central Excise Act, 1944 is - whether powdering of Low Density Polyethylene (LDPE) and High Density Polyethylene (HDPE) granules into moulding powder amounts to "manufacture".

Assessee manufactures plastic water storage tanks and toys. On 24.4.1997 the factory of assessee was visited by Officers of Anti Evasion Branch of Central Excise Commissionerate Delhi. During this visit, it was noticed that the assessee had installed the injection, moulding, extruding and pulverizing machines operated with electric power to handle plastic inputs and produce moulded shapes for manufacturing toys, water storage tanks, desks, tables etc. On enquiry, the process revealed that the moulding machine accepted the plastic input only and since the inputs, consisting of LDPE and plastic colouring material, were procured in the granular form, the same was first required to be intermixed in specified proportion and then pulverized to produce the moulding powder. This was done with extruders and pulverizers. After receiving the two inputs, the extruder through hoopers melted and mixed them in the melting and mixing chambers to produce filaments which after being cooled were chipped into small pieces. These small pieces produced with the extruder were later placed in the pulverizers which grinded them into powder.

Accordingly two show-cause notices dated 1.5.1997 demanding duty for the period October, 1996 to March, 1997 and dated 4.11.1997 for the period May 1993 to September 1996 were issued to assessee calling upon them to show-cause as to why the above process was not "manufacture" in view of note 6(b) to Chapter 39 of the Central Excise Tariff Act. 1985 (hereinafter referred to for the sake of brevity as "the 1985 Act"). According to the show-cause notices, the aforestated process constituted "manufacture" and the moulding powder constituted "excisable goods" as defined under section 2(d) of the Central Excise Rules 1944 (hereinafter referred to for the sake of brevity as "the 1944 Rules") resulting in escapement of duty from assessment. Consequently, the department issued the above two show-cause notices under rule 9 read with section 11A of the 1944 Act.

In reply, the assessee contended that conversion of granules into moulding powder did not amount to "manufacture", in terms of section 2(f) of the 1944 Act; that the said moulding powder was prepared as per specifications and requirement depending on the end product being water tanks or toys and consequently no other manufacturer besides the assessee could use the said powder prepared by the assessee. It was further contended that the said powder was not marketable and, therefore, it did not constitute "excisable goods" as defined under section 2(d) of the said 1944 Act.

By order dated 18.11.1997 and 29.12.1998, the Commissioner (Adjudication) held that conversion of granules into moulding powder constituted "manufacture" in terms of note 6(b) to Chapter 39; that both granules and the moulding powder forms fell under Tariff Heading 39.01; that while using the said powder in the manufacture of plastic water tanks and toys, the assessee should have paid duty on the basis of deemed clearances, since the powder was captively consumed; that the assessee had started the above conversion process from 10.5.1993; that the assessee was aware that the said powder was excisable and yet wilfully omitted to file the requisite classification list; that the manufacturing expenses did not include the profit margins; that even the quantity produced did not tally with the records maintained by the assessee; and consequently the Adjudicating Authority confirmed the show-cause notices under rule 9 read with section 11A of the 1944 Act. By the aforestated orders the Commissioner (Adjudication) upheld the invocation of extended period of limitation under show-cause notice dated 4.11.1997. The Commissioner (Adjudication) also found from Form-IV register that the assessee has been buying the moulding powder at times from the market.

By the impugned judgment, the Tribunal has upheld the orders of the Commissioner (Adjudication).

Mr. S. Ganesh, learned senior counsel appearing on behalf of the assessee, submitted that the process of pulverizing moulded powder did not constitute "manufacture". He contended that powdering of LDPE and HDPE granules into moulding powder did not amount to "manufacture". He submitted that the assessee is a manufacture of plastic water storage tanks, toys, chairs for children etc; that one of the raw-materials was LDPE and HDPE granules, which in turn were mixed with colouring agents/additives; that the moulding powder was made depending upon specifications of the end product and that no other manufacturer could use the moulding powder prepared by the assessee and, therefore, it was not a marketable product and hence cannot be considered as "excisable goods" in terms of section 2(d) of the 1944 Act. It was urged that since the said powder was not a marketable product, there could be no manufacture under section 2(f) of the said 1944 Act. It was further contended that no evidence was led by the department to show that the said powder was a marketable product. It was submitted that note 6(b) of Chapter 39 was not applicable as both granules and powder were of the same primary forms. It was urged that the department had only relied on stray purchases of powder for manufacture of tanks which was meant for exclusive use only by the assessee and , therefore, such instances did not prove marketability of the said product. It was further urged that the Commissioner had failed to deduct depreciation from the profit margin and accordingly, it was contended that the matter should be remitted to the Commissioner (Adjudication) for fresh determination on the question of valuation of the said powder. On the question of limitation, it was urged, that the assessee had maintained stock registers during the entire period; that these were audited; that they indicated pulverization and ,therefore, the department was not entitled to invoke the proviso to section 11A(1) of the 1944 Act vide show-cause notice dated 4.11.1997.

Shri Rajiv Dutta, learned senior counsel appearing on behalf of the department, submitted, that the above enumerated process of conversion of granules into moulding powder was a manufacturing process in terms of note 6(b) of Chapter 39 of the 1985 Act; that the purchase of the said pulverized powder on few occasions by the assessee from the market as evidenced by the registers produced by the assessee indicated that the said product was marketable; and that it constituted "excisable goods" as defined under section 2(d) of the 1944 Act. Learned senior counsel further submitted that the assessee was in the business of manufacturing of plastic water storage tanks since 1990; that from 1992, they are in the business of manufacturing of ‘toys’; that they were aware that the above process constituted "manufacture"; that they were aware that the said powder was marketable and yet they cleared the goods as non-excisable and without filing the classification list, in breach of the said 1944 Rules, solely

with the intent to evade payment of duty and, therefore, the department was right in invoking the extended period vide show-cause notice dated 4.11.1997.

Two questions arise for determination in these appeals. Firstly, whether process of conversion of granules into moulding powder constituted "manufacture" in terms of section 2(f) of the 1944 Act read with note 6(b) of Chapter 39 of the 1985 Act and whether the said powder was an "excisable product" in terms of section 2(d) of the 1944 Act? Secondly, whether on the facts and circumstances of this case, the department was right in invoking the extended period of limitation vide show-cause notice dated 4.11.1997?

In order to answer the first question, we quote sections 2(d) and 2(f) of the 1944 Act, which read as under :

"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 a manufactured product;

(ii) which is specified in relation to any goods in the section or Chapter notes of The First 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 2(f) contains two clauses and instead of setting out the activities in respect of different tariff items, clause (ii) simply states that any process, which is specified in section/chapter notes of the Schedule to the Tariff Act, shall amount to "manufacture". Under clause (ii), the Legislature intended to levy excise duty on activities that do not result in any new commodity. In other words, if a process is declared as amounting to "manufacture" in the section or chapter notes, it would come within the definition of "manufacture" under section 2(f) and such process would become liable to excise duty. The effect of this definition is that excise duty can be levied on activities which do not result in the production of a new commodity or where the raw-material does not undergo such a transformation as to loose its original identity.

As this stage, we quote note 6 to Chapter 39 of the 1985 Act, which reads as under :

"6. (a) In heading Nos.39.01 to 39.14, the expression "primary forms" applies only to the following forms :-

(i) Liquids and pastes, including dispersions (emulsions and suspensions) and solutions;

(ii) Blocks of irregular shape, lumps, powders (including moulding powders), granules, flakes and similar bulk forms.

(b) Notwithstanding anything contained in Note 3 to this Chapter, heading Nos. 39.01 to 39.14 shall also include primary forms obtained from conversion of another primary form, falling under the same heading, and such conversion shall amount to "manufacture"." Reading note 6(b), it is

clear that blocks and powders are two different "primary forms" and if the block is pulverized into powder the activity would amount to "manufacture" in terms of clause (ii) of section 2(f). By the very language of note 6, conversion from granules into moulding powder would result in "manufacture". Therefore, as a consequence of the new definition of "manufacture" in terms of section 2(f), the activities which otherwise do not amount to "manufacture" can now be treated as "manufacture" and made liable to duty.

On the question of marketability, we find from the register in Form-IV maintained by the assessee that on several occasions, the assessee had bought the moulding powder from the market, which circumstance by itself indicates that moulding powder is marketable commodity and, therefore, excisable in terms of section 2(d) of the 1944 Act. The Tribunal was, therefore, right in holding that the said powder was classifiable under Heading 39.01 of the 1985 Act.

Now on the question of valuation of the moulding powder, the Commissioner (Adjudication) found that the manufacturing expenses of the assessee did not include the profit margins and accordingly, the Adjudicating Authority worked out the profit margins on the basis of the ratio of gross profit : Sales for the year ending 31.3.1996. According to the assessee, the Commissioner (Adjudication) had erred in taking into account the gross profit of the previous year while calculating the profit margin. In this connection, reliance was placed by the assessee on Circular No. 258/92/96-CX dated 30.10.1996 issued by Central Board of Excise & Customs, New Delhi, which prescribes the formulae for calculating the value of the captively consumed goods under rule 6(b)(ii) of the Central Excise (Valuation) Rules, 1975.

The short point which arises for determination is - whether calculation of the profit margin, includible in the manufacturing expenses, should be on ‘gross profit’ or ‘net profit’ of the previous year. We do not wish to express any opinion. Suffice it to state that this issue will have to be decided by the Commissioner (Adjudication) afresh. Accordingly, we remit the matter back to the Commissioner (Adjudication) for a fresh determination in the light of the circulars no. 26/88 dated 4.4.1998 no. 258/92/96-CX dated 30.10.1996 no. 692/8/2003-CX dated 13.12.2003 as also any other circular which might have been issued by the Central Board of Excise & Customs during the relevant period.

Now coming to the second question of limitation, the facts enumerated above show that the department had issued two notices dated 1.5.1997 and dated 4.11.1997. Show-cause notice dated 1.5.1997 demanded duty from the assessee for the period October, 1996 to March, 1997 whereas the show-cause notice dated 4.11.1997 demanded duty for the period May, 1993 to September, 1996. As regards the show-cause Notice dated 4.11.1997, we find that from time to time, the assessee has maintained its record as per rule 173G in Form-IV. The said register indicated on daily basis the opening and closing balances; it indicated the stock of polyethylene raw-materials as well as the stock of pulverized powder; it also indicated use of pulverized process and lastly the said registers were certified from time to time by the officers of the department. A detailed summary was also given on the last page of the register indicating description of granules and the moulding powder with the quantity of additives. The factory of assessee was visited by the officers of the department from time to time. The assessee had assigned on several occasions their activity to job workers with the permission of the department. No objection was ever taken by the department during the aforestated period of about four years. No evidence has been brought on record to show as to on what basis the department has sought to invoke the extended period of limitation, particularly, when the department was fully aware of the process undertaken by the assessee for converting the granules into the powder. In the circumstances the Tribunal was right in directing the proceedings against the assessee to be dropped pursuant to show-cause Notice dated 4.11.1997.

Now coming to the validity of the show-cause notice dated 1.5.1997 demanding duty for the period October, 1996 to March 1997, it was urged on behalf of the assessee that the impugned show-cause notice was issued on 1.5.1997; that it was issued prior to the Amending Act 10 of 2000; that the law as it stood on 1.5.1997 authorized the department to demand duty only for six months which period now stands increased to one year in view of Amending Act 10 of 2000 with effect from 12.5.2000; hence, it was submitted that the department was not entitled to demand duty for the entire period commencing from October, 1996 to March, 1997 vide show-cause notice dated 1.5.1997. Relying on the judgment of this Court in the case of ITW Signode India Ltd. v. Collector of Central Excise, reported in [2004] 3 SCC 48. It was submitted that the object of the Amending Act 10 of 2000 was to eliminate the basis of the judgment of this Court in the case of Collector of Central Excise, Baroda v. Cotspun Limited, reported in (1999) 113 ELT 353 and, therefore, the said amendment did not extend the period beyond six months for notices given prior to 12.5.2000.

On behalf of the department, it was submitted that in view of the Amending Act 10 of 2000, the period of limitation has been extended by the Legislature from six months to one year and consequently, the demand fell within section 11A(1) as amended with effect from 12.5.2000. In this connection, reliance was placed by the department on the Circular No. 588/25/2001-CX dated 19.9.2001 issued by the Central Board of Excise & Customs, which reads as under :

"Recovery of duties not levied or not paid or short levied or short paid or erroneously refunded - Retrospective validation by Finance Act, 2000 of action taken under Section 11A of Central Excise Act, 1944.

Subject : Retrospective validation of action taken under section 11A of Central Excise Act, 1944, under Finance Act, 2000.

Attention is invited to the provisions contained in Sections 97 and 110 of the Finance Act, 2000.

2. Queries have been raised from field formations about the exact scope and amplitude of these changes. The matter has been examined in consultation with Additional Solicitor General. A copy of the opinion of ASG dated 20.4.2001 is enclosed. The Board has accepted the opinion given by the Learned Additional Solicitor General. You are requested to take follow up action in accordance with the advice of the ASG.

3. This may be brought to the notice of field formations.

4. Receipt of this circular may please be acknowledged.

5. Hindi version will follow.

OFFICE OF SHRI KIRIT N. RAVAL

ADDITIONAL SOLICITOR GENERAL

SUPREME COURT

NEW DELHI

1. My opinion is sought on the question of the scope and amplitude of the retrospective amendment to Section 11A of the Central Excise Act specifically enacted to protect the Revenue’s interest after the judgment of the Hon’ble Supreme Court in the case of Collector of Central Excise, Baroda v. Cotspun Limited, reported in (1999) 113 ELT 353. My attention is drawn to the fact that by virtue of Section 110 of the Finance Act, 2000, any action taken under Section 11A of the Central Excise Act, demanding

duty on account of non-payment, short-payment, non-levy, short-levy etc. within a period of six months or five years, as the case may be, from the relevant date as defined in clause (ii) of sub-section (3) of said section, shall be deemed to be and to always have been for all purposes validity and effectively issued or served under that section notwithstanding any approval, expense or assessment relating to the rate of duties on or value of the excisable good by any Central Excise Officer under any other provision of the Central Excise Act or the Rules made thereunder. Sub-section (2) of the said section also provides that any action taken anything done under Section 11A at any time during the said period shall be deemed to be and to have always been, for all purposes, as validity and effectively taken or done as if sub-section (1) had been in force in all material times, notwithstanding anything contained in any judgment, decree or order of any court, tribunal or other authority.

2. Thus it can be seen from Section 110 of the Finance Act, 2000 that the section seeks to grant legitimacy to all the actions taken for the recovery of the duty from the period 17.11.1980 and that any action initiated in respect of any case after such date shall be deemed to have been validly taken and any judgment, decree or order of any court, tribunal or other authority shall not be an impediment to such an action.

3. In this background, my opinion is sought on the following queries:-

(1) Whether it is correct to hold that the amendments would only cover demands for a period of six months prior to issue of SCN?

(2) Whether demands for the extended period where such demands were held as time barred on the ground that there was approved classification list/price list etc. would be covered by the amendments?

(3) Whether these provisions would apply to proceedings that have attained finality and where appeal periods have expired?

(4) Could recoveries be made in such cases, and what would be the period up to which such proceedings could be reopened and recoveries made?

(5) What would be the time limit, if any, for initiating proceedings under the amended provisions?

(6) What is the kind of notice/order that should be issued for recoveries of dues in respect of proceedings which have attained finality?

(7) How should the Department proceed in respect of matters which are pending in appeal in Tribunal and Courts?

4. My answer to the queries as under :-

QUERY NO. 1 :

In the "Negative" - in view of the fact that the word "one year" has been substituted by the word "six months" by section 97B of the Finance Act. Further, the amendment has been stated to be effected from 17th November, 1980.

QUERY NO. 2 :

In the "Affirmative" - such demands which were earlier held to be time barred because of the approval of the classification list would also be covered by the amendment as the amendment has been made retrospective w.e.f. 17th November, 1980. The factum of approval after that date will not come in the way of recovering the amounts which would be covered by such amendment.

QUERY NO. 3 :

Under Section 110 of the Finance Act, any notice issued after the 17th of November, 1980 will be protected by the validating Act. The necessity for the amendment arose to over-come the judgment of the Hon'ble Supreme Court in the Cotspun Ltd. case. Further, the power to amend the law retrospectively has been recognized judicially in a number of pronouncements [for example, Prithvi Cotton Mills Ltd. v. Broach, [1969] 2 SCC 284]. The said judgment in para 4, clearly provides "If the legislature has the power over the subject matter and competence to make a valid law, it can at any time, make such a valid law and make it retrospectively so as to bind even past transactions." Therefore, where notices have already been issued, the judgments rendered in the context of the earlier provision would cease to be of relevance. In fact, in the case of Cotspun itself, where the judgment of the Supreme Court was rendered, in view of the validating provisions, recovery could be made notwithstanding the Cotspun judgment. Under these circumstances, if the SCNs have been issued then even in respect of past proceedings which even judgments have been rendered it will be open to the Department to make recoveries.

QUERY NO. 4 :

Recoveries can be made in such cases for the period subsequent to 17th November, 1980 when the retrospective operation of the amended provisions has come into play. However, this is subject to the SCNs having been issued in time. It is also worth noting that if SCNs have not been issued so far, now it will not be open to issue SCNs for the past period unless it is within the period of limitation as prescribed under the amended provisions.

QUERY NO. 5 :

The time limit for initiating proceedings under the amended provisions would be one year for issuance of fresh notices. However, as far as recoveries pursuant to notices already issued or subject matter of pending proceedings are concerned the same are covered by answer to the previous queries.

QUERY NO. 6 :

In respect of matters which have received finality, the demand notices should be issued referring to the amendment carried out and pointing out that in view of the amended provision, it is necessary for the assessee to make the payment, as demanded. Reliance should be placed on the amendments for the purpose of making recoveries.

QUERY NO. 7 :

As far as the pending matters are concerned, the Department should file an affidavit indicating the amendment having been carried out and the request that the controversy be decided in the context of the amended provisions."

We cannot allow the assessee to raise the above contentions for the first time before this Court. In the present case, the show-cause notice dated 1.5.1997 was issued by the department in terms of rule 9(2) of the 1944 Rules read with section 11A of 1944 Act. Rule 9(2) applies to cases of clandestine removal of goods without assessment. According to the counter affidavit filed on behalf of the department, the quantity of moulded powder, cleared during October, 1996 to March, 1997 as indicated in the worksheet produced before the Commissioner, was 1,17,442 Kgs., whereas according to RG-1 Register, the quantity was 1,18,484 Kgs. Further, the assessee has not challenged the demand raised under the said show-cause notice dated 1.5.1997 as time barred even under the law as it then stood.

The contention on limitation was not argued by the assessee before the Tribunal which disposed-of the matter on 18.7.2000 (which is after 12.5.2000 when the Amending Act 10 of 2000 came into force). Rule 9(2) has been deleted with effect from 12.5.2000. In the circumstances, the matter needs to be looked into afresh by the Adjudication Authority. Since, we have remitted the matter to the Commissioner on the question of valuation, we direct him to decide also the question of limitation arising out of show-cause notice dated 1.5.1997 afresh in the light of section 11A(1), as amended and in the light of deletion of Rule 9(2) with effect from 12.5.2000.

For the aforestated reasons, we hold that the process of pulverization under which granules are converted into moulding powder constitutes "manufacture" that the moulding powder produced by the aforestated process was marketable; that the show-cause notice dated 4.11.1997 was beyond limitation; that the Commissioner (Adjudication) will decide the question of valuation under rule 6(b)(ii) of the Central Excise (Valuation) Rules, 1975, in the light of Circulars dated 4.4.1988, 30.10.1996 and 13.2.2003 issued by the Central Board of Excise & Customs; and lastly, the Commissioner (Adjudication) will also decide the question of limitation for the duty demanded under the show-cause notice dated 1.5.1997 in the light of the Circular dated 19.9.2001 issued by the Central Board of Excise & Customs as well as in the light of Amending Act 10 of 2000 under which section 11A(1) stood amended.

Accordingly, these appeals are disposed-off with no order as to costs.