LOSS DUE TO PROFIT

(S. Jaikumar & G. Natarajan, Advocates)

Captive consumption has always been captivating. That too, the valuation for such clearances, is a colossal cobweb. With the advent of Rule 8 of the present Valuation Rules, 2000, wherein, the earlier Rule 6(b)(i) was completely omitted and Rule 6(b)(ii) was thoroughly rewritten, bulk of the litigation on this front, are definitely put to rest. But is it a total solution? Let us delve a little deep.

To appreciate better, the earlier Rule 6(b) vis-à-vis the present Rule 8 is reproduced hereunder:

Rule 6(b): *"Where the excisable goods are not sold by the assessee but are used or consumed by him or on his behalf in the production or manufacture of other articles, the value shall be based –*

> *(i) on the value of the comparable goods produced or manufactured by the assessee or by any other assessee:*
>
> *Provided that in determining the value under this sub-clause, the proper officer shall make such adjustments as appear to him reasonable, taking into consideration all relevant factors and, in particular, the difference, if any, in the material characteristics of the goods to be assessed and of the comparable goods;*
>
> *(ii) if the value cannot be determined under sub-clause (i), on the cost of production or manufacture including <u>profits, if any, which the assessee would have normally earned on the sale of such goods;"</u>*

Rule 8: *" Where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be <u>one hundred and ten percent</u> of the cost of production or manufacture of such goods."(Originally 115%)*

The two ingredients of the erstwhile Rule 6(b)(ii), which were the nuclei of bulk of the litigation were:

1) The method to arrive the cost of production and
2) To arrive at the profits which the assessee would have normally earned on the sale of such goods.

Earlier, we all witnessed variety of hazard methods being adopted across the nation, to arrive at the cost of production under erstwhile 6(b)(ii). The Board had earlier prescribed its own method for the valuation of captive consumption (Circular No. 258/92/96-CX, dated 30-10-1996). The logic behind the same had been the bone of contention and feed for the majority of the litigation. There are mixed decisions both embracing and whiplashing the same.

The welcome arrival of the CAS-4 method of valuation prescribed by the Institute of Cost and Works Accountants of India, the benevolent acceptance of the same by the Board (Circular No. 692/8/2003-CX, dated 13-2-2003) and the judicious interpretation by the Saviours (Hon'ble Tribunals) that the said CAS-4 valuation has a retrospective application [2005(180) ELT 194 and a host of other judgments}, have settled the issue, by and large.

Thus the method of valuation for captive consumption is settled, at least as on date, if not once for all. Next comes the inclusion of profits. From the above, it could be seen that, by prescribing a definite percentage, the present Rule 8 has tried to eliminate the tentativeness of the earlier Rule 6(b)(ii), in determining the profit margin, for the purposes of arriving at the assessable value, for captive consumption.

Sure, the tentativeness is gone but giving way to arbitrariness!

Eventhough this prescription of 10% over the cost of production has settled the evergreen disputes between the trade and the Revenue, to a greater extent, it has also left an aggrieved segment. By this present Rule 8, all manufacturers, irrespective of their actual status, are required to add the notional 10% on their products, cleared for captive consumption or further manufacture, as envisaged under the said Rule.

Now, to the crux of the article. What is the impact of this Rule on the manufacturers, who were either making profits lesser than 10% **or** incurring losses?

In cases, where the final products are exempted/non excisable, and where the final products are sold on wafer thin margins, this Rule plays great havoc. For example, let us take the case of a knitted fabric manufacturer "A", who also manufactures its principal raw material viz., rubber thread. As on date, the knitted fabrics are exempted but the rubber thread attracts excise duty. So, the manufacturer has to necessarily adopt the valuation under Rule 8 (i.e. Cost of production plus 10%) for the rubber thread manufactured and cleared by him. Generally the rubber threads are sold in wafer thin margins (2-3%) and hence the rubber threads would be available in the market for a price much lesser than the assessable value adopted by "A", so arrived by inclusion of this notional 10%. The final product viz., knitted fabric being exempted, "A" will also be not in the CENVAT chain to avail the benefit of the duty so paid and if the profit on his final product is also less than 10%, then this Rule 8 is his graveyard.

Similarly, there is another grave consequence to this arbitrary addition of 10 % under Rule 8. Just In Time (JIT) is the buzzword of the present genre of Industrial giants, more particularly in automobile sector. The Big brothers, adopt JIT to reduce inventory holding and logistics management, at their end. JIT is a method, by which, all the suppliers of raw materials, inputs, components, accessories, packing materials etc, are required to inward their materials, only as per the schedule requirement of the OE giants. Lot of component manufacturers, who have their principal manufacturing units elsewhere in the country, have set up their assembly units near such OE manufacturers, to cater to this JIT program, so as to avoid jittery. These dependant manufacturers, manufacture the sub assemblies of the products, at their principal unit and clear the same to their assembly units situated near these auto giants, on payment of duty, as per this Rule 8. At these assembly units, only final assembly takes place and subsequently such finished goods (components) are cleared to such automobile manufacturers, on payment of duty on the transaction value, as per the JIT schedule. Normally, in such cases, the value addition at the assembly unit would be miniscule. Illustratively, if the selling price of a finished product (component) is Rs.100/-, then the cost of the sub assembly, originally manufactured and cleared from the principal unit, would be Rs.95/- and the value addition at the assembly end would be only Rs.5/-. In such cases, the component manufacturer has to adopt Rule 8 for the sub assemblies manufactured and cleared at their principal manufacturing end and pay duty for Rs.104.50/- (Rs. 95+10% of Rs.95). Even though the Cenvat credit can be availed at the final assembly unit, on such duty paid on the sub assemblies (duty o n 104.50), it shall only result in the accumulation of CENVAT Credit at the final assembly unit as ultimately the duty is paid only on the transaction value (Rs.100), thus defeating the basic purpose and intention of the CENVAT Scheme.

Fine, that's how the game is played! Larger interests always have fewer victims! Going on criticizing would only lead to a point of no return. Save these few causalities, Rule 8 has to be hailed as an earnest attempt to resolve the perpetual conflict between the taxmen and the taxed men over the interpretation and application of the Rule 6(b)(i) & 6(b)(ii) of the erstwhile Valuation Rules.

Will it not be more practical and reasonable if the notional percentage under Rule 8 is periodically revisited (may be annually) based on some scientific statistics (like GDP). Will it not be further more forthcoming and industry friendly, is the board dispenses with such notional percentage itself, as in bulk of the cases, the situation leads only to revenue neutrality!

Before parting…

An interesting case study! In a stand alone case of Steel Complex Ltd Vs CCE, Calicut, **(2004 (171) E.L.T. 255)**, the appellants were manufacturers of Steel billets, which were partly sold on ex-factory basis and the rest were sent to the job-workers for conversion of such billets to CTD (Cold Twisted Deformed) bars and rods. The converted CTD bars/rods were subsequently sold from the premises of the job workers. The department resorted to valuation under Rule 8 of the Valuation Rules, 2000 and required the assessee to adopt 115% of the cost of production (presently 110%) for the steel billets manufactured and cleared by them to the job workers for conversion into CTD bars/rods. Aggrieved assessee pleaded that, as they were a loss making company and were under reference to the BIFR (Board for Industrial & Financial Reconstruction), the requirement of addition of 115%, would be highly unreasonable and contrary to the provisions of law. They pleaded that the reasonable basis for valuation shall be the cost of production **minus** the losses and emphasized that the Rule 8 is applicable only in cases where the manufacturer makes a profit.

After considering the rival pleas the Hon'ble Tribunal has*, interalia*, observed that,

"Adopting 115% of cost of production may be a reliable method where the manufacturer in question is operating at a profit. The same norm would be wholly unreliable where manufacturer is incurring huge losses."