Supreme Court: On issue of Customs Valuation, no Customs Duty on post-importation service charges; such charges are not includable in assessable value of imported goods

Tax Alert
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Commissioner of Customs, Ahmedabad vs. M/s. Essar Steel Ltd[1]

The Hon'ble Supreme Court has declared the law that charges (fees) in relation to technical services for a project involving imported goods is not includable in the assessable value of the imported goods, under Rule 9(1)(e) of the Customs Valuation (Determination of Price of Imported goods) Rules, 1988 ("Valuation Rules") and thus are not liable to Customs Duty in India. In the context of the facts before the Hon'ble Supreme Court, it was held that these charges are in the nature of post-importation activities, therefore not exigible to duty.

FACTS

1. The respondent-importer entered into a technical service agreement with a Canadian entity, which was to render technical consultancy services in relation to a plant being successfully set-up and commissioned in India. The services were specifically in respect of a project that comprised design, procurement, construction, erection and start-up of an integrated steel plant. The agreement obligated the Canadian entity to act as a technical co-ordinator and supervise the setting up and commissioning of the plant in India. Subsequent to this agreement, in terms of a separate purchase order, the plant itself was sold by the said Canadian entity to the respondent- importer; the said plant was later imported into India.

2. The revenue department claimed / alleged that the provision of such services (under the technical services agreement) was a 'condition of sale' of the imported plant, and consequently, these service charges were required to be added to the assessable value in terms of Rule 9(1)(e) of the Valuation Rules. In effect, the revenue department demanded Customs Duty on the fees paid for these services.

3. The respondent-importer, on the other hand claimed that the provisions of Rule 9 of the Valuation Rules would not apply, as no payment was made for technical services that can be regarded as a condition of sale of imported goods. In any event, the agreement for technical services was to be performed in India post-importation, and therefore, would have to be excluded from the taxable base (value) to be taken into account at the time of the import.

JUDGEMENT

The Hon'ble Supreme Court ruled in favour of the respondent-Importer and held that the services performed under the technical service agreement were post-importation activities, which were not liable to be added to the assessable value of the imported goods. The following are the important observations by the Hon'ble Supreme Court:

1. A reading of Section 14 of the Customs Act, 1962 (the "Act") [as it stood then] makes it clear that, any amount that is referable to the imported goods post-importation, has to be necessarily excluded from the assessable value of the imported goods. It is with this basic principle in mind that the Valuation Rules, which are made under Section 14(1A) of the Act, have been framed and have to be interpreted. In this regard, the reference to an earlier judgement of the Hon'ble Supreme Court in ***Commissioner of Customs (Port), Kolkata vs. J K Corporation Ltd.***[2] is seminal, and which held that assessment of Customs Duty must have direct nexus with the value of goods which was payable at the time of importation and if any amount is to be paid after the importation of the goods is complete, inter-alia, by way of transfer of license or technical know-how for the purposes of setting up of a plant from the machinery imported or running thereof, the same would not be computed for the said purpose.

2. A reading of Rules 4 and 9 of the Valuation Rules makes it clear that only those costs and services that are actually paid or are payable for imported goods pre-import, are to be added for the purpose of determining the assessable value of the imported goods.

3. The Hon'ble Supreme Court while evaluating the agreements in question noted that there is no transfer of know-how or intellectual property and also noted that the role of the Canadian entity is basically to coordinate and advise the respondent-importer so that the respondent can successfully set up, commission and operate the plant in India. The coordination and advice is to take place post-importation after the plant is set up and commissioned in India and it was observed that all the clauses of the agreement make it clear that such services are only post-importation.

[1] Civil Appeal No. 3024 of 2004 (the judgement was pronounced on 13th April, 2015)
[2] (2007) 9 SCC 401

4. The Hon'ble Supreme Court also noted that under the purchase order, liquidated damages are only payable for the delay in commissioning the plant or failure to achieve its stipulated performance, both of which are post-importation activities. Further, a conjoint reading of the agreements does not lead to the conclusion that the technical services are, in any way, a pre-condition to the sale of the plant itself. On this basis, the Hon'ble Supreme Court concluded that Rule 9(1)(e) would not be attracted to such facts.

5. It was argued for the revenue department that the issue at hand was covered by the judgement rendered in ***Collector of Customs (Preventive) vs. Essar Gujarat Ltd.***[3] The Hon'ble Supreme Court distinguished the said judgement on facts, and held that properly read, the judgement actually supports the respondent-importer in that the payment for engineering and technical consultancy services in India cannot be added to the value of the imported plant. It was noted that in the ***Essar Gujarat*** case, the payment for the license fee was crucial inasmuch as the plant could not be operated without the payment for the license. Thus, in order to operate the plant, the license and the fee was a condition of sale of the plant itself. In other words, the Hon'ble Supreme Court observed that the plant (in ***Essar Gujarat's*** case***)*** could not be operated by the importer without the technical know-how from the identified party, and that the amounts (license fees) had to be paid before the plant could be set-up and hence the monies paid were required to be added to the value of the imported plant.

6. The Hon'ble Supreme Court relied upon its earlier judgments in ***Collector of Customs (Preventive) vs. Essar Gujarat Ltd***., ***Tata Iron and Steel Co. Ltd. vs. Commissioner of Central Excise and Customs, Bhubaneswar***[4], ***Commissioner of Customs (Port), Kolkata vs. J K Corporation Ltd***., ***Commissioner of Customs vs. Ferodo India (P) Ltd***[5] and ***Commissioner of Customs (Port, Chennai) vs. Toyota Kirloskar Motor (P) Ltd***[6] to emphasize the settled position in the context of Rule 9(1)(e) of the Valuation Rules that, post-importation charges were not to be taken into consideration for determining the transaction value of imported goods.

ELP COMMENTS

The Hon'ble Supreme Court in constituting a Bench, dedicated to hear and decide tax cases (given the large pendency of tax matters) on all working days (since 09th March, 2015) has begun to yield results, with a number of Appeals having been decided since then. Both, the quality and speed of disposal by this Special Tax Bench is laudable.

In this judgement, the Hon'ble Supreme Court has declared the law on the issue considering a factual matrix involving two separate agreements, *viz.* technical service agreement and purchase order, where the former was executed about two months prior to the purchase order. It is worthy of highlight that the Hon'ble Supreme Court found that the clause for liquidated damages (appearing in the purchase order) provided for penalties in the event of delay in commissioning of the plant and for the failure to achieve the stipulated performance, both of which were post-importation activities, and did not regard the rendition of the contracted services (under the technical service agreement) a condition for the sale of the plant; it was observed that technical services agreement was in no way a pre-condition for the sale of the plant.

This judgement of the Hon'ble Supreme Court is on an important customs valuation issue, i.e. addition of charges related to post-importation activities to compute the assessable value of the imported goods, and was rendered in the context of the Valuation Rules, which have been superseded by the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. Even so, the judgement will continue to be an authoritative pronouncement on this topic since the subject matter of the judgement, i.e. Rule 9(1) of the Valuation Rules is in *pari materia* with Rule 10(1) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

However, what is apposite in the 2007 Rules is insertion of the Explanation to the said Rule 10, which reads as follows: *"Where the royalty, license fee or any other payment for a process, whether patented or otherwise, is includible referred to in clauses (c) and (e), such charges shall be added to the price actually paid or payable for the imported goods, notwithstanding the fact that such goods may be subjected to the said process after importation of such goods."* The Central Board of Excise & Customs, has in its Circular No.38/2007-Cus., dated 09th October, 2007 clarified that: *"This Explanation has been added in the context of the Supreme Court judgment in the case of J.K. Corporation Ltd. v. Commissioner of Customs (Port) Kolkata [2007 (208) E.L.T. 485 (S.C.)] so as to clarify that such royalty, license fee, etc., if otherwise includible in terms of clauses (c) or (e) of Rule 10, will be includible in the value of the goods irrespective of the fact that such royalty, licence fee, etc., relates to a process which is made operational during the running of the machines, i.e., after importation of the goods."* Assessee-importers will have to demonstrate that monies paid for royalty or license fees or any such payment is not a condition of sale, to avoid it being added to the assessable value of imported goods and subjected to Customs Duty.

This latest judgement will be of some significance for the importer-assessees such as those importing goods for setting-up and commissioning plants in India, but, is also relevant for those drawing up contracts with suppliers, which contract involves supplies of both, goods and services.

[3] (1997) 9 SCC 738
[4] (2000) 3 SCC 472
[5] (2008) 4 SCC 563
[6] (2007) 5 SCC 371

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