CUSTOMS, EXCISE AND SERVICE TAX APPELLATE TRIBUNAL
CHENNAI

REGIONAL BENCH – COURT No. III

Customs Appeal No. 42211 of 2014

(Arising out of Order-in-Appeal C.Cus.No. 1216/2014 dated 21.07.2014 passed by Commissioner of Customs (Appeals), Custom House, No. 60, Rajaji Salai, Chennai – 600 001)

M/s. Valeo Friction Materials India Ltd. **...Appellant**
No. 16A, Sengundram Industrial Area,
S.P. Koil,
Kancheepuram – 603 204.

Versus

Commissioner of Customs **...Respondent**
Import Commissionerate,
Custom House,
No. 60, Rajaji Salai,
Chennai – 600 001.

APPEARANCE:

For the Appellant : Shri S. Ganesh Aravindh, Advocate
For the Respondent : Shri R. Rajaraman, Authorised Representative

CORAM:
HON'BLE MS. SULEKHA BEEVI C.S., MEMBER (JUDICIAL)
HON'BLE MR. VASA SESHAGIRI RAO, MEMBER (TECHNICAL)

FINAL ORDER No. 40589 / 2024

DATE OF HEARING : 27.03.2024
DATE OF DECISION: 31.05.2024

Order :- Per Mr. VASA SESHAGIRI RAO

Customs Appeal No. C/42211/2014 has been filed by the Appellant assailing Order-in-Appeal No. 1216/2014 dated 21.07.2014 passed by the Commissioner of Customs (Appeals), Chennai upholding Order-in-Original No. 23474/2014 dated 17.01.2014, ordering for invoking Section 28(4) of the Customs Act, 1962 (ACT) / Proviso to Section 28(1) of the

Customs Act, 1962, as the case may be, prior to and after Customs (Amendment & Validation) Act, 2011, to demand the differential duty of Rs.15,02,08,235/- during the period from 2001 to 2013, arising out of levy of appropriate duty on the Royalty already paid by the Appellant, along with applicable interest under Section 28AA and to invoke penal provisions under Section 114A of the ACT ibid for suppression of fact / wilful mis-statement to impose appropriate penalty.

2.1 The brief facts are that the Appellant is engaged in the manufacture and clearance of clutch facings from raw materials, imported from various foreign suppliers which are group and associate companies of M/s. Valeo Materriaux De Friction, France which were held to be related to the Appellant *vide* Order-in-Original No. 1153/2000-SVB dated 14.12.2000 and was ordered for acceptance of Transaction value under Rule 4 of the Customs (Determination of Price of Imported Goods) Rules, 1988 (CVR, 1988) as the Royalty payable to the related supplier @ 3.75% on net sale value of finished goods was held to be not includible in the transaction value of the goods imported. The said order was periodically reviewed *vide* Orders-in-Original bearing Nos. 2931/2004 dated 28.09.2004, 6884/2007 dated 23.11.2007 and 13788/2010 dated 10.12.2010 wherein it was ordered to accept the Transaction Value under Rule 4(3)(a) of CVR in line with the Original Order. During the year 2012, the auditor of the Appellant pointed out the error in computation of Royalty and consequently from July 2012, the Appellant started including the value of imported raw materials in the Net sales value for the purpose of computation of Royalty. However, with

respect to Royalty payment made until 2012, Valeo France *vide* letter dated 31.12.2012 waived the short fall towards Royalty arising out of non-inclusion of imported raw material, which fact was affirmed by the Appellant by a Sworn affidavit dated 25.04.2014. Meanwhile, the Appellant sought for renewal of the said order in October 2013 and submitted relevant documents to the Adjudicating Authority.

2.2 After due process of law, the Adjudicating Authority, *vide* Order-in-Original No. 23474 /2014 dated 17.01.2014, *interalia* ordered for addition of Royalty paid / payable on imported goods at the end of each financial year, in terms of Rule 10(1)(c) of Customs Valuation Rules, 2007 (CVR, 2007) with options to pay duty on Royalty as lump sum payment for a particular financial year or at the rates applicable to individual goods imported under each Bill of Entry for a particular year. Further, the assessing group was ordered to invoke Section 28(4) of the ACT to demand differential duty of Rs.15,02,08,325/- for the period from 2001 to 2013, along with applicable interest under Section 28AA and to invoke the penal provisions under Section 114A of the ACT *ibid* for suppression of fact / wilful mis-statement to the department, to impose appropriate penalty.

2.3 Aggrieved by the said order, the Appellant filed an appeal before the Commissioner of Customs (Appeals) contending that the Ld. Deputy Commissioner could not have passed an order covering 13 years. However, during pendency of the matter before the Ld. Commissioner (Appeals), the Department started keeping the consignments imported by the Appellant on

hold. However, since the Appellant were in urgent need of the goods for continuing the production of the goods, the Appellant paid Rs.54,65,113/- under protest and also requested for a speaking order in this respect. The Ld. Commissioner (Appeals), however, rejected the Appellant's appeal and upheld the Order-in-Original *vide* Order-in-Appeal No. C.Cus.1216/2014 dated 21.07.2014.

2.4 Aggrieved by the impugned order, the Appellant has filed the present appeal before this Forum.

3. The main grounds of appeal specified by the Appellant are:-

i. That Royalty or Licence fee is not includible in the transaction value of the imported goods, as per Section 14 read with Rule 3 of CVR, 2007 adjusted in accordance with Rule 10 of CVR, 2007, as all the conditions specified under Rule 10(1)(c) of CVR, 2007 have not been fulfilled *Viz*.:-

   a. The Royalty/ licence fee must be related to imported goods.
   b. It must be required to be paid.
   c. Such payment should be as a condition for sale of imported goods; and
   d. It is not already included in the price paid or payable for the imported goods.

ii. It was averred that Transfer of Technology agreement pertained only to final goods manufactured by the Appellant and not to the goods imported by them. As such it becomes evident that the Royalty is payable on the sale of the product manufactured by the Appellant with

respect to the value addition of the imported goods and there was no condition of sale on the imported goods.

iii. It was submitted that the inclusion of Royalty in the transaction value of the goods imported by the Appellant is contrary to the Settled position of law and that the department could not adduce evidence to show that the Royalty includible in transaction value is a condition pre-requisite for sale and the assessable value is not a true transaction value in terms of Section 14(1)(a) of the ACT and in this regard reliance was placed on the following:-

a. *Commissioner of Customs Vs. Ferrodo India Pvt. Ltd.-[2008 (224) ELT 23 (SC)]*
b. *Commissioner of Customs (Port), Chennai Vs. Toyota Kirloskart Motor Pvt. Ltd. [2007 (213) ELT 4 (SC)]*
c. *Annapurana Eracanal Pvt. Ltd. Vs. Commissioner of Customs, Chennai [2010 (249) ELT 365 (Tri.-Chennai)]*
d. *Taneja Aerospace & Aviation Ltd. Vs. Commissioner of Customs, Chennai [2008 (228) ELT 159 (Tri.-Chennai)]*
e. *Collector of Customs, Bombay Vs. Maruti Udyog Ltd. [1987 (28) ELT 309] affirmed by Supreme Court in [1989 (41) ELT A61(SC)]*
f. *Union of India Vs. Mahindra & Mahindra, [1995 (76) ELT 481 (SC)]*
g. *Panalfa Dongwon India Ltd. Vs. Commissioner of Customs, Mumbai [2003 (155) ELT 287 (LB)]*
h. *S.D.Techncial Services Vs. Commissioner of Customs, New Delhi [2003 (155) ELT 274 (LB)]*
i. *Mando Brake Systems Ltd. Vs. Commissioner of Customs, Chennai [2004 (163) ELT 283]*
j. *Polar Marmo Aglomerates Vs. Commissioner of Customs, New Delhi [2003 (155) ELT 283]*
k. *Collector of Customs Vs. Birla Yamaha Ltd. [1995 (77) ELT 170]*
l. *Saint Gobain Glass India Ltd. Vs. Commissioner of Customs, Chennai[2014 TIOL 1406-(Tri.-Chennai)]*
m. *Commissioner of Customs, Mumbai Vs. Max Atotech Ltd.-[2014 (301) ELT 531]*

iv. It was contested that the royalty / license fee cannot be said to be the condition of sale of the imported goods when such sale is on the request of the Appellant.

v. Royalty payment to be made by the Appellant to the supplier is to be computed with reference to Article 12 of Agreement which reads as follows:-

> *"12.1 In consideration for the transfer of the Technology pursuant to Article 2 hereof, the Company shall pay to Valeo, a royalty of three and three quarters percent (3.75%) of the annual Net sales Value of the Products sold by the company during a 7 year period starting from 1st January, 2000".*

By adverting to the above clause, the appellant has argued that the activities of import of goods and the payment made for technology for manufacture of the final products are wholly unrelated and therefore there is no condition of sale of the goods being valued or the imported components but only for the technical knowhow. It was further submitted that it was a settled position of law that the royalty / license fee is includible in the transaction value only if the same is paid/ payable as a condition of sale of the imported goods and reliance was placed on the following case laws:-

a. *Faiveley Transport India Ltd. Vs. Commissioner of Customs, Chennai [2009 (238) ELT 312 (Tri.-Chennai)]*
b. *India Japan Lighting Ltd. Vs. Commissioner of Customs, Chennai [2008 (23) ELT 172 (Tri.-Chennai)]*
c. *Steel Authority of India Limited Vs. Commissioner of Customs, [2007 (210) ELT 150 (Tri.)] and affirmed by the Apex Court vide [2008 (225) ELT A130 (SC)]*

vi. It was averred that the observation in the impugned order that the raw materials imported by the Appellant forms part and parcel of the Technology/ Technical Knowhow supplied by the supplier warranting payment of Royalty is only an assumption, not supported by any evidence/ material.

vii. It was submitted that the general terms of purchase and the Licence agreement are separate and pertain to two unrelated transactions and therefore, it was incorrect to consider the payment of the Royalty as a condition of sale of the imported goods especially in the absence of any such clause in the agreement to construe such payment as a condition of sale.

viii. It was submitted that the inclusion or exclusion of Royalty in the value of the imported goods cannot be decided by the method of calculation of royalty payment which is purely an arrangement between the supplier and the importer. In this regard, the decision in *Commissioner of Customs, Mumbai Vs. BASF Strenics Pvt. Ltd. [2006 (195) ELT 206 (Tri.-Mum.)]* was adverted to, in which it was held as follows:-

> *"Just because a particular formula has been designed to calculate royalty payment which also includes the raw materials cost, it cannot be said that the Royalty payment is related to the imported goods"*

ix. It was further submitted that the impugned order is contrary to the settled position of law and is based on the irrelevant ground that the calculation of Royalty by the Appellant was in violation of the terms of the agreement. The violation of the terms of the agreement was a subject matter for the parties to the agreement to accept or litigate and is of no significance as far as Customs valuation was concerned. It was pointed out the relevant criteria for Customs Valuation was whether the Royalty is related to or condition of sale of the imported goods. As the value of imported raw materials was not considered for payment of Royalty and that the supplier has waived his right to claim any arrears, it was pointed out that cannot be said to be relatable to

the imported goods or "required to be paid as a condition of sale" of the imported goods relying on the following case laws:-

a. *Commissioner of Customs Vs. Bridgestone India Pvt. Ltd.-[2013 (292) ELT 403 (Tri.-Mum.)]*
b. *ABB Ltd. Vs. Commissioner of Customs, [2013 (288) ELT 296 (Tri.-Bang.)]*

x. It was submitted that the previous orders have analysed the same agreement and department took a consistent view that the Royalty is not includible in the Transaction Value. It was further submitted that despite mistake in calculation of Royalty by the Appellant, the terms of the agreement remained unchanged from the very beginning and the copy submitted to the Department was as early as in 1999.

xi. It was averred that the SVB order dated 14.12.2000 has considered the Royalty clause under the agreement and clearly observed that Royalty payment under the said clause is not includible in the Transaction Value. Even when CVR, 1998 was replaced by CVR, 2007, department maintained the above view consistently. In the SVB order dated 10.12.2010, it was clearly observed that *"The Annual reports submitted by the importer's for the last three years have been verified and confirmed that the importer statement supra on flow back of money. Hence, there is no need for addition under Rule 10(1)(c) of Customs Valuation Rules, 2007".* Therefore, it was stressed that there is no reasonable ground for deviating from the stand taken previously by the Department.

4.1 The Ld. Advocate for the Appellant, Shri S. Ganesh Aravindh, submitted that the royalty payment pertains to post import activity of manufacture and sale of finished products and it is the settled law that

Royalty paid for post-import activity of manufacture of finished products is not includible in the transaction value of the imported materials and in this regard placed reliance on the ratio of the decisions in the case of *Commissioner of Customs Vs. GH Induction India Pvt. Ltd. [2023 (9) TMI 90-CESTAT, Chennai]* and *Commissioner of Customs (Sea), Chennai Vs. Remi Electricals India Ltd. [2017 (6) TMI 32- CESTAT, Chennai]* wherein it was held as follows:-

> *"6. The license agreement available in the appeal folder has been perused by us. Para 2 of the license agreement concerns technical know-how granted to appellants to exclusively manufacture, market, sale and distribute the licensed products within the territory agreed upon. Para 4 of the agreement specifies that for grant of such technical know-how license of technical know-how, the following amounts have to be paid:-*
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> *(a) Technical know-how license fee of ₹ 99,99,999/-; and*
>
> *(b) Running royalty on sales of each licensed product at specified rates, initially 5% and subsequently at 3% on net ex-factory price of these products.*
>
> *7. We are, however, unable to find out any condition precedent in the license agreement which ties the import of the impugned goods to the payment of the technical know-how and license fees. The imports are therefore definitely not conditional to payment by importer of additional technical know-how fees or royalty. There is no inseparable umbilical cord linking the impugned imports and the technical know-how/royalty fees. On the other hand, what we find is that these fees are directly, conspicuously and separately relatable to the manufacture and sale of products under license. It is also not the case of the department that capital goods or machinery for manufacture of the license product are involved in the current import. There is no dispute that the goods imported are nothing but automotive components."*

4.2 He has submitted that royalty paid for post-import activity i.e., manufacture of finished products cannot be added to the Transaction Value of the imported goods and the impugned order deserves to be set aside relying on the ratio of the decision in the case of *Commissioner of Customs (Imports), Chennai Vs. M/s. Vestas Wind Technology India Pvt. Ltd. [2023 (7) TMI 589-CESTAT CHENNAI]*, Wherein the Appellant had imported

various parts from various foreign suppliers and also acquired technological innovations from related foreign supplier under technical assistance agreement for the purpose of manufacture of WTG and the Hon'ble Tribunal held that royalty is not includible in the Transaction Value as there is no evidence to establish that the licence fee paid is a condition of sale of the imported goods. The relevant extract of the above decision has been reproduced below:-

> *"6. It is submitted that for the purpose of manufacturing WTGs, the respondent imports various parts from various foreign suppliers. The respondent and M/s. NEG Micon (foreign company) known as Vestas Wind Systems AS, Denmark had entered into Technical Assistance Agreement on 29.01.2000. Through the said agreement, the technological innovations made by NEG Micron were transferred to the respondent. For such transfer, the respondent would compensate NEG Micron by payment of license fee in respect of every WTG produced.*
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> *……*
>
> *18. Ld. A.R has relied upon the decision in the case of Essar Gujarat Ltd. (supra). The Hon'ble Apex Court in the case of Feroda India Pvt. Ltd. 2008 (2240 ELT 23 (SC) had occasion to analyse the very same issue and has held that the decision in Essar Gujarat Ltd. is not applicable. The Tribunal in the case of Remy Electricals India Ltd. (supra) has followed the decision of Hon'ble Apex Court in Ferodo India Pvt. Ltd. (supra) to hold that the licence fee cannot be included to the transaction value when the same is not a condition of sale."*

4.3 He has argued that even if Royalty is calculated on the value including imported components / raw materials, the same is not addable to the Transaction Value of imported goods as there is no such condition that emerges from the agreement which provides that payment of royalty is a pre-condition for import of raw materials. In this regard reliance was placed on the decision of *Kruger Ventilation Industries (North India) Private Limited Vs. Commissioner of Customs [2022 (5) TMI 496-CESTAT NEW DELHI]* wherein it was held that royalty would not be addable even if royalty is paid as a percentage of the net turnover of goods manufactured, which includes

not only the component which are domestically procured but also which are imported as well as any value addition by the appellant. The relevant portion of the decision reads as under:-

> *"22. In the present case, we find that the Technical Aid Agreement entered into between the appellant and M/s. Kruger Ventilation Industries Pvt. Ltd., Singapore was a technical aid agreement on a non-exclusive basis to manufacture and assemble centrifugal fans, axial fans, in-line fans, roof exhaust fans and mixed flow fans (goods) and to instruct the licensee in the methods of working the processes relating to or in respect of or for the manufacture of the goods and to provide total management. The restrictions in the agreement are with respect to import or export of final products by the appellant but not with respect to imports. It is also mandated that the goods were to be manufactured strictly in accordance with the specifications provided by technology provider. A license fee @ 5% had to be paid on the total net turnover of the goods. We have gone through the agreement and do not find anything in it that it also provides import of the components. Therefore, the goods were not imported under the agreement and any royalty under the agreement cannot be related to it. Further, there is no condition that the importer has to obtain the approval of the technology provider either for import or for procuring components domestically. Therefore, the royalty paid by the appellant @ 5% on the final products under the technical aid agreement cannot be said to be a condition for sale and added to the assessable value of the imported goods.* ***It is true that the royalty is paid is as percentage of the net turnover of goods manufactured, which includes not only the component which are domestically procured but also which are imported as well as any value addition by the appellant. However, this in itself, is not sufficient to add royalty to the assessable value.***
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> *23. It needs to be seen whether the payment of such royalty is pre-condition to the sale of the imported goods. No such condition emerges from the agreement in the present case. The goods were also not imported under the agreement. In view of the above, we find that the royalty cannot be included in the assessable value."*

The said decision of the Tribunal has been affirmed by the Hon'ble Supreme Court *[2023 (8) TMI 208–SC].*

Further, the Ld. Counsel relied on the decision in the case of *Commissioner of Customs, Mumbai Vs. BASF Strenics Pvt. Ltd [2006 (195) E.L.T 206 (Tri.-Mumbai)],* wherein it was held that just because a particular formula has been designed to calculate the royalty amount which also includes the raw

material cost, it cannot be said that the royalty payment is related to the imported goods. The relevant portion of the decision as follows:-

> *"9. ….*
>
> *The applicant Commissioner himself has stated in the grounds of appeal that in effect the royalties are being paid on manufacturing cost plus profit plus the value of raw materials.* ***Just because a particular formula has been designed to calculate the royalty amount which also includes the raw material cost, it cannot be said that the royalty payment is related to the imported goods. In fact, the royalty is payable on the "Net Selling Price" of all "Agreement Products" under the agreement and such products have been defined to mean "polystyrene polymers manufactured in whole or in part according to existing technology or improvement."*** *Such payment of royalty is not therefore restricted to polystyrene polymers manufactured using impugned goods imported from the related suppliers only. We find that the impugned agreement provides for payment of running royalty under the know-how agreement and relates to goods manufactured and sold indigenously. Such payment of royalty to BASF, Germany is for using BASF technology and has also been approved by the R.B.I. In view of the foregoing, we are of the view that the amount of royalty in question cannot be added to the declared value under the said sub-rule (c) either."*

It was submitted that the Hon'ble Supreme Court in the case of *Commissioner of Customs Vs. M/s. Ferodo India Pvt. Ltd [2008 (2) TMI 12-SUPREME COURT]* upheld the decision in *BASF Strenics (supra)* and held that whether payment of royalty is includible in the price or not cannot be merely on the basis of consideration clause in the agreement.

4.4 Further, it is submitted that, according to Rule 10(1)(c) of Customs Valuation Rules, 2007 ('CVR, 2007'), there are certain essential conditions, only on fulfilment of which, the said rule can be invoked to arrive at the transaction value and the above position of law has been affirmed by the Tribunal in the following decisions:-

a. *Brembo Brake India Pvt. Ltd. Vs. Commissioner of Customs [2014 (302) E.L.T. 551 (Tri.- Mumbai)]*
b. *Commissioner of Customs Vs. M/s. SICPA India Ltd. [2017 (2) TMI 608-CESTAT NEW DELHI]*

In this regard, it was submitted that in terms of the cited clauses 8 and 12 of the agreement, wherein the Appellant has a discretion not to buy raw materials from Valeo, France and will have to pay royalty on manufactured goods whether or not there are imports from the supplier in a given period which shows that the royalty payment is not related to and is not the condition of sale for the imported goods and therefore, Rule 10(1)(c) conditions are not satisfied. Hence, royalty is not addable to the value of the imported goods.

4.5 The Ld. Counsel also submitted that the inclusion of imported raw materials in the Net Sales Value is only a methodology enumerated in the agreement for calculation of royalty to be paid to the supplier which does not mean that the royalty payment is related to the imported goods and is a condition of sale for the imported goods. Further, it was pointed out that the Department failed to show how the royalty is related to the imported goods. He has argued that it was a settled position of law that if royalty is not related to the imported goods but to the final goods manufactured, then such royalty is not addable to the value of imported goods relying on the following decisions:-

a. *Commissioner of Customs Vs. Ferodo India Pvt. Ltd. [2008 (224) ELT 23 (SC)]*
b. *Commissioner of Customs (Port), Chennai Vs. Toyota Kirloskar Motor P. Ltd. [2007 (213) ELT 4 (SC)]*

Hence it was stressed that the Department failed to establish that the 'condition of sale' between the licensor and the licensee and the royalty payment is related to the imported goods.

5. The Ld. Authorised Representative Shri R. Rajaraman representing the Department reiterated the findings of the lower Adjudicating Authorities. He has submitted that value of imported raw materials constitute major portion of the clutch facings manufactured by the appellant and royalty is payable on the Net Sales Value (NSV) which includes the cost of raw materials imported. As such, the provision of Rule 10(1)(c) of Customs Valuation Rules, 2007 have been rightly invoked for addition of royalty payment to the cost of imported goods. He has argued that the appellant has failed to bring it to the notice of the Department regarding the change for computation of royalty payment by including the cost of imported raw materials and initially from the year 2000 onwards, the appellant has declared that the cost of imported goods are excluded for computation of royalty payable. He has submitted that on reading various clauses of the agreement, there is a direct nexus between payment of royalty and importation of raw materials. He has prayed for maintaining the impugned order dated 21.07.2014 and setting aside the appeal filed.

6. We have heard both sides and carefully considered the submissions, documents and evidences on record.

7. The main issues that arise for determination in this appeal are twofold: -

i. Whether royalty payments made by the appellant to Valeo, France in terms of Technology Licence Agreement are to be added or not to the value of imported raw materials in terms of Customs Valuation Rules, 2007? and,

ii. Whether the demand of differential Customs duties by such addition of royalty payments from 2000-2013 to the value of imported raw materials is legal or not in the facts of this appeal?

8. From the appeal records, it is evident that the Appellant has entered into a Technology License Agreement dated 11.02.1998 ("agreement") with M/s. Valeo, France for transfer of technology to the Appellant for the purpose of manufacturing and assembling of "products" in India for a consideration of payment of royalty which was agreed at 3.75% of the "Net Sales Value" of the product manufactured and sold. The relevant definitions are extracted herein below for ease of reference:

> *"Article 1 Definitions*
>
> *1.6 "Net Sales Value" shall mean gross sales value of the Products (defined below) as per invoice to Company customers **less** the usual trade discounts, refunds for returned goods, taxes including excise duties, packaging costs, transportation costs, FOB an European airport or port of shipment (as defined in the 1990 Incoterms, import customs duties, as amended from time to time), insurance, **cost of imported components** and/or complete knocked-down parts and/or semi knocked-down parts, and/or standard bought-out components, regardless of the source of import **(excepting raw materials).***

1.7 "Products" shall mean the friction material products listed.in Appendix 2 hereto using the Technology (defined below) and designed and developed by VALEO.

1.10 "Technology" shall mean the technical knowledge (whether patented or unpatented), design formulae~ technical know-how, patents (listed in Appendix 1 hereto), procedures for manufacturing, secret and confidential information, which have been developed or acquired by VALEO and ***which are used for the manufacture of the Products.*** *The Technology is embodied in the Technical Documentation and the Technological Documentation.*

Article 2 License

VALEO hereby ***transfers the use of the Technology*** *on an exclusive, non-transferable and non-assignable basis, in order to manufacture and assemble the Products in India and to sell the Products in India and in the Export Territory, for the duration of the Agreement.*

Article 3 Quality Control; Quality Certificate

3.1 The Company shall comply strictly with the Technical Documentation and the Technological Documentation to be provided by VALEO.

3.2 Before the start of the mass production and marketing of any Product, any such Product shall pass a quality checking test to be conducted on samples of a trial production made by the Company, first by the Company itself and then by VALEO, pursuant to VALEO's quality specifications and acceptance procedures (the "Quality Checking Test").

Article 5 Technical Assistance

5.1 Upon the Company's request, VALEO shall send industrialization specialists to the Company's plant in India for up to 150 men-working days (in aggregate for all the Products), the cost of such technical assistance shall be borne by VALEO. If the Company wishes to extend such limit, an agreement shall have to be reached between the parties on the duration of such extension and the related cost shall be borne by the Company.

Article 6 Training

6.1 Upon the Company's request, VALEO shall train Company personnel (such personnel shall have the education level of engineers) in one (1) or more of VALEO's plants to be designated by VALEO for up to 200 men-working days in aggregate for all the Products; the cost of such training shall be borne by VALEO. If the Company wishes to extend such limit, an agreement shall have to be reached between the parties on the duration of such extension and the related cost shall be borne by the Company.

Article 7 Marking of the Products

7.1 The Products and their packaging shall indicate "Manufactured by Valeo Friction Materials India" and shall be marketed under the trademark "VALEO". The graphic of all such markings in which the name "VALEO" shall be written in accordance with its logotype specifications, shall be approved by VALEO.

7.2 The right to use the name VALEO referred to in Article 7.1 hereof shall be exercised by the Company according to the terms and conditions set forth in the VALEO Trademark License Agreement entered into between the Parties on February 11, 1998.

Article 8 Purchase of Parts and Materials

***At the Company's reasonable request**, VALEO shall supply the Company with parts and raw materials necessary to the manufacture of the Products on terms to be determined by the Company and VALEO.*

Article 12 Consideration and Payment Conditions

*12.1 In consideration for the transfer of the Technology pursuant to Article 2 thereof, the Company shall pay to VALEO a royalty of **three and three quarters percent (3.75%) of the annual Net Sales of Product sold by the Company** during a 7- year period starting on 1st January 2000.*

12.2 The value of fibre yarn and/or impregnated yarn to be supplied by VALEO to the Company shall be considered as a raw material for the purpose of calculating royalty payments to be made to VALEO under this Article 12. In the event that such characterisation of the fibre yarn and/or impregnated yarn is not possible for whatever reason, the parties hereby agree to adjust the royalty rate immediately in order to ensure an equivalent amount of quarterly of royalty payments to be made hereunder."

From the above, it could be seen that the Technology Agreement provides for the framework for transfer of technology from Valeo, France to the Appellant for manufacture and sale of Finished "Products" defined under Article 1.7 of the Agreement.

9. We find that as per clause 12.1 of the agreement, the said agreement was to be in force for a period of 7 years from 01.07.2000 which was renewed periodically vide 3 Supplemental Agreements. From

01.08.1997 to 31.03.1999, royalty was not payable by the Appellant under the agreement which has also been verified by a Chartered Accountant *vide* the Certificate dated 27.09.1999. From 1999-2000, the Appellant started paying royalty, which was calculated on Net Sales Value excluding, inadvertently, the value of imported raw materials. Though the agreement stipulated that the Net Sales Value is inclusive of value of raw materials, the same was not included in the Net Sales Value while calculating the amount of royalty to be paid upto July 2012.

10. The issue of the relationship between the Appellant and the supplier influencing the transaction value was examined and the Ld. Deputy Commissioner of Customs (SVB), Chennai *vide* Order-in-Original No. 1153/2000-SVB dated 14.12.2000 held that the royalty was not addable to the Transaction Value of the imported goods because the same can be added only when it was related to imported goods that too as a condition of sale. Subsequently, the said SVB order was reviewed and transaction values were accepted by subsequent SVB orders:-

a. Order-in-Original No. 2931/2004 dated 28.09.2004.
b. Order-in-Original No. 6884/2007 dated 23.11.2007.
c. Order-in-Original No. 13788/2010 dated 10.12.2010.

All these facts are not disputed.

11. A perusal of the impugned order dated 21.07.2014 of the Lower Appellate Authority indicates that quantification of Customs duty payable as adopted by the Original Adjudicating Authority was doubted as recorded in Paragraphs 17 and 18 of the said order which read as under:-

> *"17. In terms of the 'said Agreement' only the cost of 'raw material' to be included for the purpose of calculation of royalty amount and again 'fibre yarn and impregnated yarn' are only considered as 'raw material'. It is not known whether the LAA had considered only the above mentioned 'raw material' or all the imported material to arrive at the percentage. Moreover, the method of calculating the royalty amount to be included in the Transaction Value from the already paid total royalty amount is not correct.*
>
> *18. Appellant though not agreed to the fact that the royalty to be included in the Transaction Value, to prove the LAA's method of calculation of royalty was wrong, appended with the grounds of appeal a chart showing the value of 'raw material' only year wise and the actual amount supposed to be paid as royalty also year wise. According to the appellant the royalty amount supposed to have been paid (though actually not paid or to put it other words, payable) worked out to Rs.3,88,01,446/- for the period from 2000-01 to 2012-2013. The department arrived at the same as Rs.15,02,08,325/-. Prima facie it appears that if at all the royalty amount that was payable to be included in the Transaction Value, the Appellant's calculation needs to be given due weightage. In other words the percentage of royalty (3.75%) on the raw material, which was paid by the appellant to the foreign supplier but not actually included in the declared invoice price, should be included in the transaction value for the purpose of calculation of duty."*

12. We find that as per Rule 10(1)(c) of Customs Valuation Rules, 2007 ('CVR, 2007'), there are certain essential conditions, only on fulfilment of which the said rule can be invoked to arrive at the transaction value by including royalty / license fees payment.

a. The royalty/ license fee must be related to the imported goods;

b. It must be required to be paid by the buyer; and,

c. Such payment should be a condition of sale of the imported goods.

13. As such, it is essential to examine whether the payment of royalty is anyway linked to import of raw materials and whether sale of raw materials is a pre-condition in the present appeal. A reading of various clauses of Agreement indicate that the royalty is payable at 3.75% of the annual net sales of the product sold by the Company. There is a clear formula regarding the method to arrive at the above net sales value of the product sold. The royalty payment covers transfer and use of technology providing information of technical knowledge, design formula, technical know-how, procedures for manufacturing and secret and confidential information which have been developed or acquired by VALEO which are used for the manufacture of the products *viz.,* clutch facings. Even initially the products manufactured by the Indian Company would be evaluated by VALEO, France in order to ensure the products confirmed to the quality specifications and accepted procedures prescribed by VALEO. Such royalty payment also covers technical assistance in sending industrialization specialists to the appellant's plant in India for imparting training to the employees of the appellant. It also covers training of the appellant's personnel at VALEO's plants located abroad. From the Technology Licence Agreement, it is also evident that the products manufactured by the appellant and even their packing will be utilizing the VALEO trade mark. Thus, the right to use the name 'VALEO' shall be exercised by the appellant according to the terms and conditions flowing from the Technology Licence Agreement.

14. In Article 8 of the Agreement, it is clearly indicated that at the appellant's request, VALEO shall supply the parts and raw materials necessary to the manufacture of the products on the basis of the terms to be determined by the appellant and VALEO. All this indicate that payment of royalty is not entirely related to import of raw materials. Even, the value of other products like copper wire, resins, semi-finished clutch facings, *etc.,* required for manufacture of finished goods i.e., Clutch Facings from the associate companies of M/s. VALEO Materiaux De friction, France are to be deducted from the net sales value.

15. From the above, it can be safely inferred that payment of royalty is not completely relatable to import of raw materials as there is no condition of sale attached for their import. Distinction which exists between an amount payable as the condition of import and amount payable in respect of sale of manufactured goods using the brand name has to be understood properly. Rule 10(1)(c) of the Customs Valuation Rules, 2007 states that royalties and licence fees related to the import goods that the buyer is required to pay directly or indirectly as a condition of sale of the goods have to be added to the transaction value of the imported goods. We find that there is no such condition that emerges from the agreement between the appellant and the VALEO, France which provides that royalty payment is a pre-condition for sale / import of raw materials. There is no evidence to establish as to how the royalty payment is linked to the import of raw materials.

16. Article 12 of the agreement relating to consideration and payment states that the appellant shall pay to VALEO a royalty of 3.75% of the annual Net Sales Value of products sold and value of fibre yarn and impregnated yarn to be supplied by VALEO shall be considered as a raw material for the purpose of calculating royalty payments and in the event that such characterization of the fibre yarn is not possible for whatever reason, there is a provision to adjust the royalty rate. The above Clause of Article 12 has given rise to the suspicion that importation of goods is connected and related to the royalty payments. Whereas, after going through the other Articles of the Agreement relating to provision of technical assistance, training, and usage of the brand name of the appellant on the products manufactured by the appellant indicates that the royalty payment is not limited to importation of raw materials but covers comprehensively many other aspects of manufacturing and sale of licenced products. Article 8 of the Agreement relating to purchase of parts and materials states that VALEO shall supply the parts and raw materials necessary to the manufacture of the licenced products on terms to be determined by the appellant and VALEO. After reading the entire agreement comprehensively, it is to be inferred that though the payment of royalty is tagged to net sales value of the licenced products with so many deductions excepting raw materials is linked to not only supply / importation of raw materials and other goods semi-finished clutch facings, *etc.,* but also linked to provision of technical assistance, documentation, transfer of technology, training of the personnel of the appellant both in India and abroad and also permission to use the trade mark VALEO on the products manufactured by the appellant.

17. The Order-in-Original dated 17.01.2014, had quantified the differential duty payable to be Rs.15,02,08,325/- for the period from 2000-2013 on the basis of percentage of imported raw materials used for manufacture of finished goods and the amount of royalty paid. The above method of computation of royalty is clearly against the prescribed procedures and rules. The above computation assumes that the entire royalty payment is related to import of raw materials. Even the Lower Appellate Authority has found fault with such a quantification though upheld that the royalty paid is having a nexus with the importation of raw materials and as such royalty paid has to be included in the value of the imported raw materials. The appellant has not only imported the raw materials like fibre yarn and impregnated yarn but also various other raw materials like textured yarn, technical yarn, copper wire, resins even semi-finished clutch facings. So, linking the raw materials imported entirely to royalty payment is not legal and cannot be accepted.

18. We find that the issue of inclusion of Royalty in transaction value is no more Res Integra in view of the ratio of the decision in the case of *Kruger Ventilation Industries (North India) Private Limited Vs. Commissioner of Customs, [2022 (5) TMI 496-CESTAT NEW DELHI]* which was affirmed by the Hon'ble Supreme Court, as relied upon by the Ld. Counsel for the Appellant. We also find that the ratio of the following decisions supports the cause of the Appellant:-

i. *Commissioner of Customs, Chennai Vs. M/s. GH Induction, India Pvt. Ltd. [2023 (9) TMI 90-CESTAT CHENNAI]* wherein it was held

that Royalty is not addable to the Transaction Value of the imported goods as the technical knowhow was for the post import (manufacturing) activity.

ii. *Commissioner of Customs (Sea), Chennai Vs. M/s. Remy Electricals India Ltd. [2017 (6) TMI 32-CESTAT CHENNAI]*

iii. *Commissioner of Customs (Imports), Chennai Vs. M/s. Vestas Wind Technology India Pvt. Ltd. [2023 (7) TMI 589-CESTAT CHENNAI]* wherein it was held that royalty is not includible in the Transaction Value as there is no evidence to establish that the licence fee paid is a condition of sale of the imported goods.

19. It is pertinent to note that in terms of the cited clauses 8 and 12 of the agreement, the Appellant has a discretion not to buy raw materials from Valeo, France and will have to pay royalty on manufactured goods whether or not there are imports from the supplier in a given period. This shows that the royalty payment is not related to and is not the condition of sale for the imported goods and therefore, Rule 10(1)(c) conditions are not satisfied. Hence, royalty is not includible in the value of the imported goods. We find that in the case of *Brembo Brake India Pvt. Ltd. Vs. Commissioner of Customs [2014 (302) E.L.T. 551 (Tri.-Mumbai)],* it was held that royalty and other charges are not includible in assessable value if Payment of royalty and other charges not for imported goods and not a condition of sale of goods . The relevant extracts of the above decision have been reproduced below:-

> *"We have carefully considered the submissions and perused the records. The department has sought to load royalty relating to the*

technical know-how as per Rule 10(l)(c). Undisputedly the appellants have imported components for the manufacture of Disc Brake Systems for two wheelers. The department has sought to load the assessable value as per Rule 10(l)(c) which is reproduced for convenience of the reference :-

Rule 10(1)(c). - Royalties and licence fees related to the imported goods that the buyer is required to pay, directly or indirectly, as a condition of the sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable;

The following explanation has been added to Rule 10(l)(c).

"Where the royalty, licence 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 good, notwithstanding the fact that such goods may be subjected to the said process after importation of such goods".

From the above it is clear that the royalty and the other charges can be included:

(i) In case of imported goods

(ii) As condition sale of goods

And the explanation only added that such royalty would be includable' in the case even if the imported goods have undergone the said process after importation of such goods. The department could not show that the royalty and other charges were for the imported goods and they were as a condition of sale of such imported goods. Undisputedly the royalty on technical know-how was paid only for the manufacture sub-assembly of Dis Brake Systems. Therefore the royalty and other charges are not includible and the impugned order is not sustainable and is set aside. The appeal is allowed."

20. Further, relying on the following decision of higher judicial fora, the appellant has argued that the royalty payment is only for providing technical assistance for manufacture and sale of licenced products and import of raw materials is incidental to such manufacture and sale. There is no condition of sale attached to importation of raw materials and having not

met the required conditions of Rule 10(1)(c), payment of royalty amounts cannot be added to the transaction value of import of raw materials. In the case of *Commissioner of Customs Vs. Ferrodo India Pvt. Ltd. [2008 (224) ELT 23 (SC)]*, it was held as follows:-

> *" 23. In the case of Matsushita Television & Audio India Ltd. v. CoC reported in 2007 (211) E.L.T. 200 (S.C.) the question which arose for determination was whether royalty amount was attributable to the price of the imported goods. In that case, the appellant was a joint venture company of MEI, Japan and SIL for obtaining technical assistance and know-how. Under the agreement, the appellants were to pay MEI a royalty @ 3% on net ex-factory sale price of the colour TV receivers manufactured by the appellants for the technical assistance rendered by MEI. The appellants were to pay a lump-sum amount of U.S. $ 2 lakhs to MEI for transfer of technical know-how. It was the case of the appellant that payment of royalty was not related to imported goods as the said payment was made for supply of technical assistance and not as a condition pre-requisite for the sale of the components.*
>
> *24. One of the questions which arises for determination in this civil appeal is whether reliance could be placed by the Department only on the Consideration Clause in the TAA for arriving at the conclusion that payment for royalty was includible in the price of the imported components.*
>
> *25. Rule 4(3)(b) of the CVR, 1988 provides for an opportunity for the importer to demonstrate that the transaction value closely approximates to a "test" value. A number of factors, therefore, have to be taken into consideration in determining whether one value "closely approximates" to another value. These factors include the nature of the imported goods, the nature of the industry itself, the difference in values etc. As stated above, Rule 4(3)(a) and Rule 4(3)(b) of the CVR, 1988 provides for different means of establishing the acceptability of a transaction value. In the case of Matsushita Television (supra) the pricing arrangement was not produced before the Department. In our view, the Consideration Clause in such circumstances is of relevance. As stated above, pricing arrangement and TAA are both to be seen by the Department. As stated above, in a given case, if the Consideration Clause indicates that the importer/buyer had adjusted the price of the imported goods in guise of enhanced royalty or if the Department finds that the buyer had misled the Department by such pricing adjustments then the adjudicating authority would be justified in adding the royalty/licence fees payment to the price of the imported goods. Therefore, it cannot be said that the Consideration Clause in TAA is not relevant. Ultimately, the test of close approximation of values require all circumstances to be taken into account. It is keeping in mind the Consideration Clause along with other surrounding circumstances that the Tribunal in the case of Matsushita Television (supra) had taken the view that royalty payment had to be added to the price of the imported goods.*
>
> *26. For the aforestated reasons, we find no infirmity in the impugned orders of the Tribunals. Accordingly, the civil appeals filed by the Department are hereby dismissed with no order as to costs"*

Further, we find that in the case of *Commissioner of Customs (Port), Chennai Vs. Toyota Kirloskart Motor Pvt. Ltd. [2007 (213) ELT 4 (SC)]*, it was held as follows:-

> *"31. The transaction value must be relatable to import of goods which a fortiori would mean that the amounts must be payable as a condition of import. A distinction, therefore, clearly exists between an amount payable as a condition of import and an amount payable in respect of the matters governing the manufacturing activities, which may not have anything to do with the import of the capital goods."*

21. In view of aforesaid discussions and the judicial precedents cited above, we are inclined to hold that Royalty payment is not includible in the transaction value of imported raw materials. Thus, the issue of inclusion of Royalty payment in the transaction value of the imported raw materials is decided in favour of the Appellant and we order so accordingly

22. On the issue of invoking extended period, we note that the appellant has placed the same copy of Technology Assistance Agreement before the SVB authority from 1999-2000 onwards to 2013-2014. There was no change as to computation of Net Sales value but its interpretation. The Audit team of appellant's accounts has pointed out that for computation of royalty, the cost of imported raw materials was to be added in terms of correct interpretation of the same agreement. The appellant have produced evidence that VALEO, France has waived additional royalty payable if the cost of raw materials were to be included in the Net Sales Value for period from 2000-2001 to 2011-2012. We find that the Department was well

aware of the issue all along and the Appellants have provided all documents and clarifications and nothing prevented the Department from launching an investigation against the appellant from 2000 to 2012. Instead, from 2000-2012, the department was of the view that that Royalty payments were not includible in the transaction value as held in four Orders-in-Original and further, the Department never preferred to consider filing an appeal against the impugned orders. Having not done so, the department cannot invoke the extended period at a later date to demand duty on the grounds of suppression of facts by the Appellant. Hence, we do not find it legally sustainable to invoke the extended period in this case. We find that the Original Adjudicating Authority has demanded differential customs duty by including the royalty payment in transaction value of imported raw materials for the period from 2000-2001 to 2012-2013. The appellant's declared transaction values of various imported goods including raw materials have been accepted from time to time *vide* Orders-in-Original dated 14.12.2000, 23.11.2007 and 10.12.2010. Even by invoking the extended period, how the differential customs duty could be demanded for 13 years which is blatantly illegal and against the provisions of customs law. It is also on record that these Orders-in-Original have been accepted and not challenged in Review proceedings. On this account only, the differential duty demand has to be set aside.

23. Hence, in view of the above discussions and by appreciating the ratio of the above decisions, we are of the considered view that the Royalty is not includible in the transaction value of the imported raw materials to

demand any differential customs duty. The impugned order is set aside as being legally unsustainable and the appeal filed by the party is allowed with consequential benefits, if any, as per the law.

(Order pronounced in open court on 31.05.2024)

Sd/-
(VASA SESHAGIRI RAO)
MEMBER (TECHNICAL)

Sd/-
(SULEKHA BEEVI C.S.)
MEMBER (JUDICIAL)

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