Reportable

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 5003 OF 2006

Commissioner Central Excise, Bangalore ... Appellant(s)

Versus

M/s. United Spirits Ltd. & Anr. ... Respondent(s)

J U D G M E N T

Dipak Misra, J.

The respondent is a manufacturer of Indian Made Foreign Liquor (IMFL) and is a registered owner of several known brands of IMFL. The respondent, as the facts have been unfolded, also "manufactures" food flavours at its unit at Shayura Orchards, Kumbalagodu, Bangalore and the present appeal pertains only to food flavours.

2. The respondent has got its own distillery units at various places. In addition, it has entered into agreements

with various manufacturers of liquor who had their bottling plants and also appropriate licences to manufacture liquor. With these liquor manufacturers the respondent had entered into Usership Agreement whereby they were permitted to use the trademark of the respondent on IMFL manufactured by them on the terms and conditions mentioned in the agreement. The respondent had also entered into another agreement with the liquor manufacturers called the manufacturing agreement which provides for manufacture and sale by liquor manufacturers of IMFL under the respondent's brand names or its purchase by the respondent on the terms and conditions mentioned in the agreement. It is stipulated in the agreement that sale and purchase of IMFL under the agreement shall be on principal to principal basis. These liquor manufacturers were to purchase raw materials such as rectified spirit, extra neutral alcohol and blending and packing materials in accordance with the standards and specifications set forth in the agreement and from the approved suppliers. It was also provided in the manufacturing agreement that

modalities of price payable by the respondent to the liquor manufacturers for sale of IMFL and the price was to be the aggregate of cost of rectified spirit, extra neutral alcohol, blending and packing materials, storage, insurance premium and all manufacturing costs and expenses as mentioned in the agreement. In addition, the liquor manufacturers were entitled to the margin of profit called service charges in the agreement. The total price so paid to the liquor manufacturers was the sole consideration for the sales and such price is known as Ex-Distillery Price (EDP), which includes all costs, charges and expenses incurred by the liquor manufacturers for manufacture of IMFL as well as their margin described as service charges. The IMFL manufactured by liquor manufacturers was affixed with the brand names owned by the respondent. It provided the manufacturing logo, quality control, product research, etc. The respondent provided technical know-how/expertise to liquor manufacturers for manufacture of IMFL.

3. The liquor manufacturers sell IMFL manufactured by them either to the respondent or to the customers

identified by the respondent or to the government-owned corporations. The sales personnel of the respondent contact the customers, book orders, collect outstanding amounts from the market, collect statutory forms like C-Forms, Excise Verification Certificates, Permits, etc. and forward the same to the liquor manufacturers. The respondent would promote its brands through marketing teams and operation of various promotional schemes and advertisements and all expenses with regard to the same are incurred by the respondent. The liquor manufacturers were entitled to receive EDP which include the actual cost of IMFL manufactured by them plus the profit margin. The prices were negotiated by the respondent even when the goods were sold by the liquor manufacturers to such buyers and they would bill by such buyers at the rates negotiated and determined by the respondent.

4. The respondent, however, asserts that such rates/prices negotiated with outside buyers were either more or less than the EDP with certain consequences, namely, (a) if the selling price to outside customers is more than EDP, the difference was paid by the liquor

manufacturers to the respondent by calling it under different nomenclature like royalty or service charge; (b) if the selling price to outside customers was less than EDP, the difference/shortfall is borne by the respondent and paid to the liquor manufacturers; and (c) if the price realized from outside buyers is more than EDP, the difference accrued to the respondent.

5. As has been stated earlier, the respondent "manufactures" food flavours at its food flavour manufacturing unit at Bangalore. On the said aspect, the respondent asserts that the food flavours were "prepared" by mixing of various essences (odoriferous substances) purchased by the respondent from different suppliers.

6. Food flavours it is accepted play a role in the flavour profile of the liquor. Food flavours are not used in all brands of IMFL. There are certain brands of IMFL in which no food flavours are used and wherever they are used in IMFL, the percentage is very low ranging from 0.0001% to 00019% per litre. However, it is not the case of the respondent, that food flavours do not matter in the

IMFL business.

7. Food flavours were supplied by the respondent to their IMFL manufacturing units and also sold to liquor manufacturers who were manufacturing IMFL under manufacturing/usership agreements. Food flavours were also sold to third party manufacturers of IMFL. The liquor manufacturers under the manufacturing agreement would use food flavours in such proportions as identified by the respondent and the blending proportion was maintained as a trade secret of the respondent.

8. The respondent stands registered under the Central Excise Act, 1944 (for short, "the Act") for manufacture of food flavours falling under Sub-Heading No. 3302.10 of the Central Excise Tariff since 1994 and holds the Central Excise Registration Certificate No. 8/94. Food flavours manufactured by the respondent have been always cleared on payment of central excise duty. As a procedure, the respondent used to file price lists/declarations from time to time declaring the assessable value of food flavours in accordance with law. The assessable value included the

entire cost of raw material, labour cost, overheads and profit margin and were cleared from the factory on payment of central excise duty. The price of food flavours supplied to the respondent owned IMFL manufacturing units, liquor manufacturers and to other independent IMFL manufacturers, it is asserted by the respondent, did not vary and remain identical.

9. The royalty paid to the respondent by the liquor manufacturers, as asserted, is the difference between their selling prices of IMFL to outside buyers and the EDP of such IMFL. As pleaded, the payment of royalty has no nexus or connection with the food flavours. There are several brands of IMFL where no food flavour was supplied by the respondent to liquor manufacturers. However, royalty on the difference between the selling price of IMFL and EDP was still paid. The respondent claims that there were several instances where food flavours were sold and used in IMFL but no royalty was received. In those cases the selling price of IMFL was lower than the EDP and rather than receiving royalty, the respondent had borne the shortfall and reimbursed the same to liquor

manufacturers. On this ground, the respondent intends to put forth the stand that royalty was solely relatable to the higher selling prices of IMFL over and above EDP and has nothing to do with food flavour. The food flavours were not used in IMFL products like Signature Whisky, Centenary Whisky, Single Malt Whisky, etc. which were manufactured without using food flavours. In respect of the same, the liquor manufacturers manufacturing the said brand were paying royalty to the respondent, that being the difference between their selling price of the said brands and their EDP.

10. We have narrated the aforesaid factual scenario as substantially put forth by the respondent. At this juncture, it is necessary to state that revenue issued a show cause notice on 11.04.2000 on the ground that the respondent-assessee received additional consideration from its franchisees in the form of royalty for supplying food flavours which were essential ingredients of the IMFL manufactured by the franchisees. The proviso to Section 11A of the Act was invoked by the adjudicating authority and it was propose to re-determine the assessable value of

food flavours by including the royalty received by the assessee. The differential duty demanded for the period April, 1997 to March, 2009 was 35,45,865,860/-. Penalties were proposed on the unit and on the Senior Manager (Taxation) and interest was also levied. The adjudicating authority confirmed the demand vide his order dated 29.08.2002. The respondent approached the Customs, Excise and Service Tax Appellate Tribunal (for short, "tribunal") which in its order dated 08.07.2003 remanded the matter to the learned Commissioner as certain invoices of sales were produced before the tribunal which were not considered by the concerned Commissioner. While remitting the matter, the tribunal observed that as the matter was being remitted, the issue of limitation and such other issues were kept open for the adjudicator to re-determine and pass an appropriate order granting the opportunity to the parties for effective hearing. The issue of penalty was also kept open.

11. After the remit, the adjudicating authority passed an order on 27.02.2004. It placed reliance on the decision in ***Pepsi Foods Ltd. v. Collector of Central Excise,***

Chandigarh[1], and held that the royalty from the various units under the manufacturing agreement deserve to be included in the assessable value of the food flavour supplied to them and accordingly confirmed the demand under proviso to Section 11A of the Act. Equal amount of penalty was imposed under Section 11 AC and interest under Section 11AB was also levied. A penalty of Rs. 3,00,000/- was imposed on the Senior Manager (Taxation) under Rule 26 of the Central Excise Rules, 2002.

12. Before the tribunal, it was contended by the assessee that it purchased duty paid essences from various suppliers and simply mixed them by a process of manual mixing in the proportion developed by the respondent and which was kept as a top secret and the mere process of manual mixing of the essence did not amount to manufacture; that though the said issue was raised before the jurisdictional Assistant Commissioner on 18.02.2000 and a prayer was made to consider their plea that the food

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1 (2005) 9 SCC 28

flavour produced by them was not excisable and, pass an appropriate order, the concerned authority did not respond to the same and thereafter, the assessee informed the department that till a final decision was taken, the duty would be paid under protest. It is further contended that food flavours were odoriferous compounds and the quantum of food flavours used in IMFL wherever used were very negligible ranging from 0.0001% to 0.0019% per litre of various IMFL products and such use had no relevance in the marketability of IMFL product nor its final market price. Referring to the letters dated 18.02.2000 and dated 04.09.2001 wherein the assessee had taken a stand that mixing of duty paid flavours would not amount to manufacture. It reiterated the stand that it was not a manufacture on the basis of the decision rendered in ***Union of India & Ors v. Delhi Cloth and General Mills Co. Limited and Others***[2]. Reference was also made to the order passed by the Commissioner, Central Excise, Hyderabad who vide his letter dated 22.09.2003 had held that the mixing of duty paid food flavours could not result

[2] 1997 ELT (J199)SC

in emergence of a new product and the resultant essence which comes into existence in the premises of M/s. Shaw Wallace Co. (SWC) does not answer the test of marketability and as the facts are identical in the case of the assessee, the same should have been followed by the jurisdictional Commissioner. To bolster the said stand, reliance was placed on ***Delhi Cloth and Generals Mills Co. Limited (supra), South Bihar Sugar Mills Limited & Anr. Etc. v. UOI & Anr, Etc***[3]**,** and ***Tata Chemicals Limited v. R.M. Desai, Inspector, Central Excise, Mithapur & Others, Moti Laminates Private Limited v. CCE (SC)***[4], ***Kilpest India Limited v. CCE (Tri.)***[5]**,** ***XI Telecom Limited v. Supdt. Of Central Excise, Hyderabad(AP-DB)***[6]**,** and ***CCE v. Jagatjit Industries (SC)***[7].

13. It was further argued that in certain cases, the flavours which were not bought are not even mixed but were supplied directly to the bottlers, only the labels were

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[3] 1978 ELT (J 336)
[4] 1995 (76) ELT 241
[5] 1999 (108) ELT 786
[6] 1999 (105) ELT 263
[7] 2002 (141) ELT 306

changed in order to maintain secrecy and such an activity could not be regarded as 'manufacture' inasmuch as under Chapter Heading 3302.10 re-labelling does not amount to manufacture. It was argued that mixing of flavours does not bring into existence a new product and even after mixing flavours, the resultant products still remains to be a flavour only. Attention of the tribunal was invited to Board's Circular No. 247/81/96-CX dated 03.10.1996 clarifying that mixing duty paid paints to obtain paint in different shade would not amount to manufacture. Further submission before the tribunal was that flavours were either mixed or supplied in the form in which they were purchased to the bottlers and cannot be marketed to anyone else and no other manufacturer would buy these flavours, for they were meant only for use in the product manufactured for the assessee.

14. Commenting on the nexus between the royalty and the price of food flavours, it was canvassed before the tribunal that the royalty and service charges were received by the assessee for use of the trade mark and for

marketing services provided by it to the contract bottling units and even though flavours were supplied to independent manufacturers, neither royalty nor service charges were received from them and hence, the royalty bill had no nexus with the price of the food flavour. That apart, it was argued that the assessee sold food flavours to Contract Bottling Units who employed them to manufacture IMFL products or to different other brand owners to whom they were paying royalty and service charges. However, the other brand owners paid only the price of flavours to the assessee and this would be indicative of the fact that the royalty had no nexus with the price of the flavours. Additionally, it was propounded that material was purchased before the concerned Commissioner showing that assessee had sold some kind of flavour to certain distilleries with whom there was no bottling agreement nor there was any receipt of royalty or service charges because the contract unit had not applied the brand of the assessee nor secured services of the assessee for marketing and in such a case, the

Commissioner could not have asserted that the agreement was for sale of flavour and receipt of royalty and service charges. Reliance on the ***Pepsi Foods Ltd.*** (supra) was seriously criticised before the tribunal as the ratio laid down was not applicable to the case at hand. Before the tribunal the learned counsel for the assessee had drawn attention that the manufacturing agreement and usership agreement to highlight certain aspects, to draw distinction and the adjudicating authority could not have proceeded to allocate the entire receipts to the value of food flavours alone without any basis. Criticising the invocation of the jurisdiction under Section 11A of the Act, it was contended that there was no suppression on the part of the appellants as the factum of payment of royalty was known to the department and it was clear from the note of the Range Officer to the Deputy Commissioner which clearly laid down that the amount paid towards royalty was only for use of the brand name for sale of flavour and prior to the issue of show cause notice, there was an audit inspection on 28.03.2001 and the assessee was asked to

clarify various points raised which had been clarified vide letter dated 28.04.2001 and all these aspects had not been taken into consideration while invoking the jurisdiction. It was also put forth that as royalty had no nexus with the price of food flavours, the assessee was not expected to declare it and, therefore, it could not be treated as suppression. That apart, at the time of audit objection even the Range Superintendent was of the view that there was no nexus between the royalty received by the appellant and the price of food flavours sold by the assessee and, therefore, in the obtaining circumstances, the notices were clearly barred by time.

15. The stand and stance put forth by the assessee was controverted by the revenue contending, *inter alia*, that the department had raised the question of excisability of the product in question, when it found the modification of stay order Nos. 838 and 839/2004 dated 10.08.2004 by the High Court. It was also urged that there was an earlier proceeding in 1995 relating to food flavour and the case was adjudicated by the then Commissioner, consequent

upon which the assessee had started paying duty and hence, excisablity of the product in question was never an issue at all as the conduct of the assessee would reflect. Reference was made to Entry 3302 in the Tariff and 3302.10 to highlight that the tariff itself recognizes mixtures of odoriferous substances as excisable product and, hence, it could not be said that no manufacture was involved in the mixing of the essences to produce such food flavours. It was urged that goods to fit into the term 'manufacture' must be capable of being bought and sold in the market and to be known as such. In that regard, placing reliance on ***Bhor Industries Ltd v. CCE, Bombay***[8], ***Union Carbide v. CCE***[9], ***Moti Laminates Pvt. Ltd. & Ors v. CCE, Ahmedabad***[10], ***Union Of India & Others v. Sonic Electrochem (P) Ltd. and another***[11] and ***CCE, Chandigarh-II v. Jagatjit Industries Ltd.***[12], it was canvassed that in the case at hand the food flavours manufactured by the assessee were marketable as

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[8] (1989) 1 SCC 602
[9] 1986 (24) ELT 169 (SC)
[10] (1995) 3 SCC 23
[11] (2002) 7 SCC 435
[12] (2002) 3 SCC 614

evidenced from the assesse's admissions that it has been selling food flavours to other independent bottlers who were not manufacturing the IMFL brands of McDowell but their own brands which establish marketability of the product. It was further argued that the inputs were essences and once they were mixed or prepared, they lost their original identity. It was also urged that though the input and finished goods were under the same tariff heading, still there was manufacture and the finished goods were having distinct, separate and identifiable function, with reference to the product, i.e., IMFL. The further stand was that mixing amounts to manufacture as has been laid down in ***Gopal Zarda Udyog v. CCE, New Delhi***[13], ***O.K. Play (India) Limited v. CCE, New Delhi II***[14], ***Nestle India Limited v. CCE, Chandigarh II***[15], ***T.N. State Transport Corporation Limited v. CCE, Madurai***[16], ***Kothari Products Limited v. Government of Andhra Pradesh***[17], ***CCE, Guntur v. Crane Betel Nut***

[13] 2005 (188) ELT 251 (SC)
[14] 2005 (180) ELT 291 (SC)
[15] 2004 (169) ELT 315 (Tri-Del)
[16] 2004 (166) ELT 433 (SC)
[17] 1998 (98) ELT 315 (AP)

Powder Works[18], and ***Henna Export Corporation v. CCE***[19]. The revenue further contended that as per Section 4 of the Act, the assessable value depends on the nature of transaction and each price in a transaction was an assessable value and it cannot be compared if the type of transaction was different. The assessee received royalty charges from buyers who were contract bottling units and separate assessable value was computable for these types of customers and in such cases, the royalty charged by the assessee from the buyers has to be treated as additional consideration.

16. After noting down the submissions of the learned counsel for the parties, the tribunal adverted to the issue of nexus between the royalty and the price of food flavours. The tribunal clearly stated that in the year 1995, the department had proceeded against the assessee for non-payment of central excise duty on the food flavours produced by them and the Commissioner confirmed the demands raised and at that time, the excisability of food

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[18] 2005 (187) ELT 106 (Tri-Bang)
[19] 1993 (67) ELT 907 (Tribunal)

flavours was not questioned by the assessee. After the adjudication order dated 30.01.1995, the assessee was clearing the goods on payment of duty. During 2001, the departmental audit raised certain objections with reference to the receipt of certain amounts towards royalty, service charges, etc. from the contract bottling units engaged in the manufacture of IMFL and according to the audit, the royalty charges should be added to the value of the food flavour sold to the contract bottling units. At that juncture, the assessee gave justification for non-inclusion of royalty charges. The tribunal, as the impugned order would reflect, has adverted in detail to the justification given by the assessee before the adjudicating authority which was basically founded on the conditions set out in the agreement that royalty was payable by the manufacture for use of the brand name and that the royalty had no relevance with the goods or various inputs that go into the manufacture of these goods. It was also set forth that the brands of the company had their own value and the royalty receivable from the manufacturer

was primarily on account of company's brands of finished goods, namely, IMFL viz. No. 1 Brandy, No. 1 Whisky, Diplomat Whisky, Premium Whisky, Dry Gin, etc. It was also contended that the audit party had erroneously mis-interpreted the concept of royalty as one which was capable of being subdivided into and allocable to various manufacturing inputs, for it is neither feasible nor a correct procedure to apportion the royalty which was accruing to the company on the company's brand image. It was also contended that such an understanding would defeat the purpose of the agreement. Though such a stand was explained by the assessee, yet the department was of the view that the royalty should be added to the assessable value and consequently first show cause notice dated 11.04.2002 was issued. The tribunal thereafter chronologically analysed the facts and order of remit and the *de novo* order and perused the relevant agreements of the appellants with the CBUs. On scrutiny of the agreements, the tribunal found that there were two agreements, one is called the Manufacturing Agreement

and the other is Usership Agreement. As per the terms and conditions of the agreement, the products were to be manufactured by the second party would include the products whose trade mark was owned by the assessee-appellant before the tribunal and any other associate company of it. The second party to the agreement was required to purchase blending and packing materials from such suppliers specified by the assessee and above condition was for the purpose of ensuring quality specification. The agreement defined the blending material. The tribunal referred to the definition of "Blending Material" and opined that the said definition includes food flavours. It referred to para 18 of the agreement which stipulates that during the currency of the agreement, the second party (as pointed out by the tribunal) Gemini Distilleries (Tripura) Pvt. Ltd. (GDPL) shall not use trade mark to or adopt any trade mark similar to any of the trade marks on or in connection with any product. On that basis, the tribunal opined that on careful reading of the agreement reveals that the assessee

has good control over the manufacture of IMFL by GDPL and it ensures the quality of the product, which bears the trade mark of the assessee. Referring to the usership agreement, the tribunal observed that the proprietor was the assessee and the user was GDPL and according to the said agreement, at the request of the user, the proprietor had agreed to permit the user to use the trade marks in respect of the goods on the terms and conditions mentioned in the agreement. The tribunal referred to para 12 of the agreement which postulates that in consideration of this licence, the user shall pay to the proprietor such sum per case manufactured of the goods as may be mutually agreed upon by the parties from time to time and the consideration shall be paid by the user by the following month. It further observed that though the word royalty has not been used in the agreement, it was clear that the sum mentioned in para 12 of the agreement refers to royalty and the royalty was for the use of trade mark and there was no indication whatsoever to infer that the royalty was paid for supply of food flavour. It took note of

the fact that food flavour was one of the blending materials and not the sole blending materials sold by the assessee to the CBU and hence, *prima facie*, there does not appear to be any close nexus between royalty and the food flavour.

17. Be it noted, the assessee before the tribunal highlighted that there were three types of transactions, namely, receipt of royalty and also supply of food flavours; royalty was received though there was no supply of food flavours; and royalty was not received even though there was supply of food flavours. Accepting the said submission, the tribunal held thus:-

> "The appellants took us through the various documents and showed us that there is practically no difference in price in respect of sales to independent buyers and the prices at which food flavours are sold to CBUs. This fact clinches the issue. It is very clear that there is no nexus between the royalty and the food flavours. The adjudicating authority has relied on the Apex Court's decision in the Pepsi case. In our view, the ratio of the above decision should not have been blindly applied as done by the adjudicating authority. In the Pepsi case, both the concentrate and the final product are excisable which is not the case in the present appeals. The final product here is IMFL for which royalty is paid. IMFL is not subjected to Central Excise duty. In the Pepsi case, the concentrate is the most essential ingredient of Pepsi Cola whereas in the present case, it is not so. There are certain

> brands of IMFL which do not require any food flavour. In the Pepsi case, the concentrates are sold only for the franchisees. In the instant case, the appellants have sold food flavours to independent manufactures of IMFL who will not be using the brand name of the appellants. Such independent manufacturers would not pay any royalty. In the Pepsi case, an express prohibition restricting the bottlers to purchase the concentrate from any other source was there. No such express prohibition is there in the present agreement. It was further pointed out by the appellants that there are instances wherein the appellants have paid an amount to bottlers when the sale price of IMFL is much below the ex-distillery price. It is further seen that apart from food flavour, the appellants supplied other blending materials to these CBUs. In these circumstances, the entire royalty paid cannot be attributed to the food flavour whose cost is only 0.45% according to the appellants. Further we find that even in 2001, at the time of audit inspection, the appellants have taken a firm stand not only regarding the includibility of royalty but also the question of very excisability of the food flavour itself. In these circumstances, there is no justification for alleging suppression of facts to invoke the larger period. Hence the Show Cause Notice dated 11.04.2002 and 08.03.2004 are clearly time barred. For the above mentioned reasons, the royalty has no nexus with the price of the food flavour and hence, not includible in the assessable value. Moreover, the first two Show Cause notices are time barred as there is no suppression of facts."

18. After so stating, the tribunal addressed the issue pertaining to excisability of food flavours. It took note of the fact that there was purchased duty paid odoriferous compounds called essences and these essences were

mixed manually to obtain food flavour. In what proportion and which essences were to be mixed has been kept a trade secret and different brands of IMFL require food flavour of different profiles. In order to ensure the quality consistency in the various brands of IMFL, the production of food flavour was centralized at Bangalore which does not use power. The tribunal referred to Board's circular dated 22.11.1999 wherein it has been clarified that agarbati manufacturing process involving simple mixing of a few aromatic chemicals with the base oil in a container in liquid form, which was mixed directly with the dough or applied on agarbati in the required proportion used for rolling of agarbati is not excisable product and, therefore, no duty was leviable on such compounds during the course of manufacture of agarbati. It was urged before the tribunal that the fact situation in the case of assessee was similar, as has been clarified in the Board's circular in respect of agarbati. It is further urged that there was a simple mixing of essences of different flavour profile and the food flavours produced by the assessee are exclusively used for making their brands of IMFL in their own units

and contract units and it cannot be sold in the market as such. The tribunal posed a question whether the process of mixing of essences results in a distinct commodity, which was different from the original inputs. In that context, it held thus:-

> "We find that both the essences and the resultant product food flavour fall under the same Tariff Heading. Since different proportion of the ingredients give different flavours to the resultant product, we cannot say that a ingredients give different flavours to the resultant product, we cannot say that a completely distinct product emerges. The comparison with agarbathi mention in Board's Circular is justified. Board's Circular dated 03.11.1996 deals with the process of tinting of duty paid base white Paint with duty paid strainer to obtain paint of different shades. It has been clarified that the above process does not amount to manufacture on the ground that the process of tinting does not bring about any new commodity with different commercial identity as the resultant emulsion/enamel point and hence, it may not be appropriate to consider this process as amounting to manufacture. While clarifying the above position, the Board has applied the ratio of the classic judgment of the Apex Court in the DCM case wherein it has been held that "Manufacture implies change, but every change is not manufacture and yet every change in an article is a result of treatment, labour and manipulation, but something more is necessary and there must be transformation; a new and different article must emerge having distinctive name, character and use."
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> In another Circular dated 13.07.1992, the Board has clarified that conversion of plain plastic

> granules into coloured plastic granules would not amount to manufacture.
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> In all these cases, the commercial identify of the ingredients and the finished product remained the same. In the present case also, the process of mixing two or more essences in certain proportions does not bring into existence any new product. The essence remained essences only and because of the different proportion, a distinct flavour is imparted to the resultant product. That cannot make the process as manufacture."

19. To arrive at the said conclusion, it placed reliance on ***CCE Chennai v. Fountain Consumer Appliances Limited***[20], ***Tega India Limited v. CCE, Calcutta II***[21], ***State of Maharashtra v. Mahalaxmi Stores***[22], and ***CCE Chennai v. Titanium Equipment & Anode Manufacturing Co. Ltd.***[23]

20. We have heard Mr. Yashank Adhyaru, learned senior counsel for the appellant and Ms. Indu Malhotra and Mr. S.K. Bagaria, learned senior counsel for the respondents. It is submitted by the learned counsel for the appellant that the final product 'food flavour' is classified under Chapter Heading 3302.10 and hence is excisable and dutiable. According to him, the assessee

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[20] 2004 (171) ELT 329 (Tri-Chennai)
[21] (2004) 2 SCC 727
[22] (2003) 1 SCC 70
[23] 2002 (142) ELT 162 (Tri-Chennai)

itself had admitted that it was selling the food flavours to independent bottling units and that establishes the marketability of the product. The assessee had claimed that its product is custom made and the formula is a trade secret and further it had availed CENVAT credit of inputs for payment of duty on final product. As the facts had been established, contend Mr. Adhyaru, the finished goods are sold on different code numbers assigned by the assessee, hence a new identity is established. Learned senior counsel would urge to construe a particular good has been manufactured, the goods must be capable of being bought and sold in the market, as has been held by this Court in ***Bhor Industries Ltd.*** (supra), ***Jagatjit Industries Ltd.*** (supra) and ***Servo Med Industries Pvt. Ltd. v. CCE***[24]. Learned senior counsel would contend that mixing which is prefixed by simple fixing by the assessee is not acceptable because the process of mixing can amount to manufacature as has been held in ***Gopal Zarda Udyog*** (supra) and ***O.K. Play (India) Limited*** (supra). As far as the royalty is concerned, it is urged by

[24] 2015 (6) SCALE 137

him that the assessee had received royalty charges from buyers who are contract bottling units and separate assessable value is computable for this type of customers.

21. In the instant case, as the revenue would put forth, the royalty/service charge received by the assessee under the various agreement with other manufacturers of IMFL forms additional consideration and is includible in the assessable value under Section 4 of the Act read with Valuation Rules as has been held in ***Pepsi Foods Ltd.*** (supra).

22. Mr. Bagaria and Ms. Indu Malhotra, learned senior counsel appearing for the assessee in their turn would contend that the food flavours were odoriferous compounds and are prepared by way of simple mixing of various essences (odoriferous substances) purchased from different suppliers and thus the food flavours that were obtained from simple mixing of duty paid essences/flavours done manually cannot be regarded as manufacture, for by such mixing no new commodity having existing name, character or use emerges. That apart, in around 26% of the cases even such mixing was

not done and the flavours purchased from the market were cleared as such merely after relabeling and when flavours fall under the Heading No. 3302.10, no extended meaning is to be given to the expression 'manufacture'. Reliance has been placed on circular no. 247/81/96-Cx. dated 03.10.1996 issued by CBEC, Ministry of Finance, Government of India, which had clarified that the process of tinting of base emulsion/enamel paint with strainers to obtain paint of different shades does not amount to 'manufacture' within the meaning of Section 2(f) of the Act. It was their further submission that tribunal has rightly made the comparison between the process of tinting of base emulsion/enamel paint with strainers with the process of mixing two or more essences in certain preparation to arrive at the conclusion that no process of manufacture was involved in the case of the assessee. It was urged that it is well settled that mere mention of the goods in one of the Entries in the schedule to the Central Excise Tariff would not render them exigible to excise duty unless the twin tests of manufacture and marketability were satisfied. It has also been repeatedly held that

manufacture implies a change but every change was not manufacture and in order to attract the concept of manufacture, there must be transformation of the raw materials into a new and different article having a distinctive name, character and use. In that regard reliance has been placed on ***Union of India v. Ahmedabad Electricity Co. Ltd & others.***[25], ***Hindustan Zinc Ltd. v. CCE, Jaipur***[26], ***Delhi Cloth & General Mills*** (supra) and ***Satnam Overseas Ltd. v. CCE, New Delhi***[27]. It has been emphatically put forth that a simple process of mixing do not amount to manufacture as there is no transformation of the inputs into any new or differential commodity and for the said proposition, reliance has been placed on ***CCE, Bangalore-II v. Osnar Chemicals Private Ltd.***[28], ***CCE, Meerut v. Goyal Gases (P) Ltd.***[29] and ***Crane Betel Nut Powder Works v. Commr. of Customs & Central Excise, Tirupathi***[30]. Further stand of the respondent is that in respect of the Sub-Heading

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[25] (2003) 11 SCC 129
[26] (2005) 2 SCC 662
[27] (2015) 13 SCC 166
[28] (2012) 2 SCC 282
[29] (2000) 9 SCC 571
[30] (2007) 4 SCC 155

3302.10 which covers food flavours, no artificial or extended meaning has been given to the expression 'manufacture' by the legislature by exercising the power under Section 2(f)(iii) and hence, it cannot be regarded as manufacture. Heavy reliance is placed on the decisions in ***Shyam Oil Cake Ltd. v. CCE-I, New Delhi, Jaipur***[31] and ***CCE v. S.R. Tissues (P) Ltd.***[32] As far as the stand of the revenue that the assessee at one point of time had accepted the process of mixing and manufacture and paid the duty under the specified heading, it would debar the assessee to raise the plea again is sans substance as the Commissioner himself had admitted that food flavours were prepared by simple manual mixing of odoriferous substances but by the assessee. That apart, the assessee was entitled to raise such an issue in respect of the subsequent period and is not stopped to do so in view of the decision in ***Municipal Corporation of City of Thane v. Vidyut Metallics Ltd.***[33] As far as the conclusion arrived at by the tribunal that two show cause notices dated 11.04.2002 and 30.04.2004 are barred by

[31] (2005) 1 SCC 264
[32] (2005) 6 SCC 310
[33] (2007) 8 SCC 688

limitation, no fault can be found with it inasmuch as the said show cause notices were issued after expiry of one year from the period covered thereunder and hence, plea barred by limitation as provided under Section 11A(1) of the Act. As regards the limitation, learned senior counsel for the respondent have drawn inspiration from ***Cosmic Dye Chemical v. CCE, Bombay***[34], ***Padmini Products v. CCE, Bangalore***[35], ***Pushpam Pharmaceuticals Co. v. CCE, Bombay***[36] and ***Uniworth Textiles Ltd. v. CCE, Raipur***[37]. As far as penalty imposed under Section 11AC is concerned, it is urged that there has been no fraud or collision or wilful mis-statement or suppression of facts or contravention of provisions of the Act or the Rules with the intention to evade payment of duty and, therefore, the authorities could not have mechanically imposed the penalty and the tribunal is absolutely justified in setting aside the same.

23. From the factual narration and the submissions advanced at the Bar, we find three issues, namely,

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[34] (1995) 6 SCC 117
[35] (1989) 4 SCC 275
[36] 1995 Supp (3) SCC 462
[37] (2013) 9 SCC 753

(i) whether there was 'manufacture', (ii) whether there was nexus in royalty received and the price paid for the food flavour sold, and (iii) whether two show cause notices have been correctly determined to be barred by limitation by the tribunal. First we shall advert to the issue of 'manufacture'. The submission of the respondent is that they are mixing essences and in some cases merely selling food flavours purchased from third parties without any processing and in any case mixing of essences under no circumstances can amount to manufacture. The said submission is founded on the principle that by such process of mixing change takes place and no separate and marketable commodity comes into existence. Various judgments have been cited at the Bar to explain the term 'manufacture'. It is well settled in law that 'manufacture' implies change, but every change is not manufacture, such change is normally a result of treatment, labour and manipulation. In this regard, we think it appropriate to to reproduce a passage from ***Union of India v. Delhi Cloth & General Mills Co. Ltd.***[38] wherein the Constitution

[38] AIR 1963 SC 791

Bench quoted with approval from an American judgment in ***Anheuser-Busch Brewing Assn. v. United States***[39], which is to the following effect:-

> "'Manufacture' implies a change, but every change is not manufacture and yet every change of an article is the result of treatment, labour and manipulation. But something more is necessary and there must be transformation; a new and different article must emerge having a distinctive name, character or use."

24. In ***Deputy Commissioner of Sales Tax (Law), Board of Revenue (Taxes), Ernakulam v. Pio Food Packers***[40], a three-Judge Bench while interpreting Section 5-A(1)(a) of the Kerala General Sales Tax Act, 1963 opined that:-

> "There are several criteria for determining whether a commodity is consumed in the manufacture of another. The generally prevalent test is whether the article produced is regarded in the trade, by those who deal in it, as distinct in identity from the commodity involved in its manufacture. Commonly manufacture is the end result of one more processes through which the original commodity is made to pass. The nature and extent of processing may vary from one case to another, and indeed there may be several stages of processing and perhaps a different kind of processing at each stage. With each process suffered, the original commodity experiences a change. But it is only when the change, or a series of changes, take the commodity to the point where

[39] 207 US 556 (1908)
[40] 1980 Supp. SCC 174

> commercially it can no longer be regarded as the original commodity but instead is recognised as a new and distinct article that a manufacture can be said to take place. Where there is no essential difference in identity between the original commodity and the processed article it is not possible to say that one commodity has been consumed in the manufacture of another. Although it has undergone a degree of processing, it must be regarded as still retaining its original identity."

25. After so stating, the Court posed the question: does the processing of original commodity brings into existence a commercially different and distinct article? In that context, the three-Judge Bench analysed the ratio in previous decisions and stated thus:-

> "Some of the cases where it was held by this Court that a different commercial article held come into existence include *Anwarkhan Mahboob Co.* v. *State of Bombay*[41] (where raw tobacco was manufactured into bidi patti), *A. Hajee Abdul Shakoor and Co.* v. *State of Madras*[42] (raw hides and skins constituted a different commodity from dressed hides and skins with different physical properties), *State of Madras* v. *Swastik Tobacco Factory*[43] (raw tobacco manufactured into chewing tobacco) and *Ganesh Trading Co., Karnal* v. *State of Haryana*[44], (paddy dehusked into rice). On the other side, cases where this Court has held that although the original commodity has undergone a degree of processing it has not lost its original identity include *Tungabhadra Industries Ltd., Kurnool* v. *CTO*[45], (where hydrogenated ground-

[41] AIR 1961 SC 213
[42] AIR 1964 SC 1729
[43] AIR 1966 SC 1000
[44] (1974) 3 SCC 620
[45] AIR 1961 SC 412

> nut oil was regarded as groundnut oil) and *C.S.T., U.P., Lucknow* v. *Harbilas Rai and Sons*[46] (where bristles plucked from pigs, boiled, washed with soap and other chemicals and sorted out in bundles according to their size and colour were regarded as remaining the same commercial commodity, pigs bristles)."

26. Adverting to the fact situation which pertained to pineapple fruit and canned pineapple slices, the Court held:-

> "In the present case, there is no essential difference between pineapple fruit and the canned pineapple slices. The dealer and the consumer regard both as pineapple. The only difference is that the sliced pineapple is a presentation of fruit in a more convenient from and by reason of being canned it is capable of storage without spoiling. The additional sweetness in the canned pineapple arises from the sugar added as a preservative. On a total impression, it seems to us, the pineapple slices must be held to possess the same identity as the original pineapple fruit."

27. In ***Collector of Customs, Bombay v. S.H. Kelker & Co. Ltd.***[47], the assessee had imported an organic chemical "abbalide" which the assessee had classified under Chapter 29 and not as an odoriferous substances under Heading 33.02 of the tariff. Reversing the judgment of the

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[46] (1968) 21 STC 17 (SC)
[47] (2000) 10 SCC 478

tribunal, it was held by the Court as under:-

> "10. Heading 33.02 of the Tariff refers to
>
> "mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in industry".
>
> It envisages (*i*) mixtures of odoriferous substances, and (*ii*) mixtures (including alcoholic substances) with a basis of one or more of odoriferous substances and the mixtures are of a kind used as raw materials in industry. In the present case, it has been found that the chemical, in its original form, consists of various isomers and is an odoriferous substance. It has been dissolved in diethyl phthalate, a non-odoriferous substance. The odoriferous substance is the basis of the mixture. It is not disputed that the mixture is used as a raw material, viz., perfume in industry. It can, therefore be said that the compound is a mixture with a basis of an odoriferous substance and since it is for use as a raw material in industry, it would be classifiable under Heading 33.02.
>
> 11. In our opinion, the Tribunal was in error in construing clause 1(*e*) of Chapter 29 and in holding that the said product was classifiable under Chapter 29. Clause 1(*e*) of the Notes in Chapter 29 postulates that if a product mentioned in sub-clauses (*a*), (*b*) or (*c*) of clause 1 is dissolved in a solvent and the solution constitutes a normal and necessary method of putting up these products adopted solely for the reasons of safety or for transport then the product would fall within Chapter 29 only if the solvent does not render the product particularly suitable for specific use rather than for general use. As per the certificate dated 19-9-1986 issued by the manufacturer the compound imported by the respondents cannot be used in the condition it is manufactured and for

> making it suitable for use and for retaining its suitability for use it has to be dissolved in a solvent. The need of a solvent is not only for the purpose of storage and transport of the chemical, but also for retaining the suitability of the product after it is manufactured. Its dissolution in the solvent is necessary in order to make the product suitable for use. Since the product is used only for perfumery and not for any other purpose, it has to be held that the product is intended for specific use only. In view of clause 1(*e*) of the Notes in Chapter 29, it may be held that the product imported by the respondents cannot be regarded as falling under Chapter 29 of the Tariff and would fall under Heading 33.02 in Chapter 33 of the Tariff. We are, therefore, unable to uphold the impugned judgments of the Tribunal."

28. We have referred to the decisions to highlight the concept of essential change in the character of the product. In this regard, useful reference may be made to the authority in ***Income Tax Officer, Udaipur v. Arihant Tiles and Marbles Pvt. Ltd.***[48], the Court after referring to ***CIT v. M/s N.C. Budharaja and Company***[49], opined thus:-

> "25. Applying the above tests laid down by this Court in *Budharaja case* to the facts of the present cases, we are of the view that blocks converted into polished slabs and tiles after undergoing the process indicated above certainly results in emergence of a new and distinct commodity. The original block does not remain the marble block, it becomes

[48] (2010) 2 SCC 699
[49] 1994 Supp (1) SCC 280

> a slab or tile. In the circumstances, not only is there manufacture but also an activity which is something beyond manufacture and which brings a new product into existence and therefore, on the facts of these cases, we are of the view that the High Court was right in coming to the conclusion that the activity undertaken by the respondent assessees did constitute manufacture or production in terms of Section 80-IA of the Income Tax Act, 1961.
>
> 26. Before concluding, we would like to make one observation. If the contention of the Department is to be accepted, namely, that the activity undertaken by the respondents herein is not manufacture, then, it would have serious revenue consequences. As stated above, each of the respondents is paying excise duty, some of the respondents are job-workers and the activity undertaken by them has been recognised by various government authorities as manufacture. To say that the activity will not amount to manufacture or production under Section 80-IA will have disastrous consequences, particularly in view of the fact that the assessees in all the cases would plead that they were not liable to pay excise duty, sales tax, etc. because the activity did not constitute manufacture."

29. At this juncture, it is obligatory to state that revenue has heavily relied upon on ***Pepsi Foods Ltd.*** (supra). In the said case the Court had found that the consideration payable as royalty was an inevitable consequence of the sale of the concentrate and in such circumstances the price paid for the concentrate was not the sole consideration paid by the purchaser. The terms of

agreement had obligated the bottler to purchase the concentrate from the assessee alone, use the assessees' trade mark on the bottled beverage and also pay royalty for assessees' trade mark at the specified percentage of the maximum retail price of each bottle. In the given circumstances and evidence available, it was held that the price actually paid for sale of concentrate was not to be the determinative factor as the price paid for the sale of concentrate, i.e., invoice would not be determinative, as the royalty payment was inseparably linked with the sale consideration paid for the concentrate. The indelible nexus and connect was established to club the two considerations.

30. The respondent, in its turn, has placed reliance on ***Shyam Oil Cake Ltd.*** (supra) and contended that mere separate tariff entry is not indicative whether the same amounts to manufacture, for tariff entry can be merely for the purpose of identifying the product and the rate applicable to it. In such case, it would not have the effect of rendering the specified commodity to be excisable. Section 2(f) defines "manufacture" and by deeming effect, a

process can amount to manufacture. Albeit, for a deeming provision to come into play, it must be specifically stated that a particular process amounts to manufacture. The respondent has also placed reliance on Circular no. 495/61/99-CX-3 dated 22nd November, 1998, but the said circular relates to compound preparation during the course of manufacture of agarbati. In the context of the said product, clarification was issued. It is noticeable that the respondent had pleaded a different factual matrix which has been accepted by the tribunal, albeit, without referring to specific details. General observation and broad brush approach need not reflect true consideration paid for all transactions. A far greater and deeper scrutiny of facts is required before forming any opinion, one way or the other. It would be wrong to be assumptuous without full factual matrix being lucent and absolutely clear.

31. Recently, in ***The Additional Commissioner of Commercial Taxes, Bangalore v. Ayili Stone Industries Etc. Etc.***[50] the Court was dealing with the issue of grant of exemption on polished granite stone and

[50] Civil Appeal Nos. 1983-2039 of 2016 dated 18.10.2016

the view of the revenue that the polished and unpolished granite stones are under separate Entries in the second schedule to the Karnataka Sales Tax Act, 1957. The question arose before this Court pertained to interpretation of polished and granite stones and in that context the concept of manufacture and after referring to various judgments, it held that:-

> "28. There is a distinction between polished granite stone or slabs and tiles. If a polished granite stone is used in a building for any purpose, it will come under Entry 17(i) of Part S of the second schedule, but if it is a tile, which comes into existence by different process, a new and distinct commodity emerges and it has a different commercial identity in the market. The process involved is extremely relevant. That aspect has not been gone into. The Assessing Officer while framing the assessment order has referred to Entry 17(i) of Part S but without any elaboration on Entry 8. Entry 8 carves out tiles as a different commodity. It uses the words "other titles". A granite tile would come within the said Entry if involvement of certain activities is established. To elaborate, if a polished granite which is a slab and used on the floor, it cannot be called a tile for the purpose of coming within the ambit and sweep of Entry 8. Some other process has to be undertaken. If tiles are manufactured or produced after undertaking some other activities, the position would be different. A finding has to be arrived at by carrying out due enquiry and for that purpose appropriate exercise has to be undertaken. In the absence of that, a final conclusion cannot be reached."

32. In the case at hand, as we find from the order of the tribunal the exact nature of the process undertaking and how mixing is undertaken and the process involved is not discernible and has not been ascertained and commented. It remains ambiguous and inconclusive. The respondent claims that about 26% of the sales of odoriferous substances were brought from third party and sold without any modification or process. These are all questions of fact which must be first authenticated and the actual factual position validated. The tribunal has answered the question in favour of the respondent without the background check as to the actual process involved and undertaken. Different flavours may have different processes.

33. The third issue relates to the issue of limitation. The tribunal has held that certain show cause notices are barred by limitation. Mr. Bagaria, learned senior counsel has submitted that the said conclusion is absolutely flawless, if the dates are taken into consideration. For the aforesaid purpose, he has commended us to the decision already referred to hereinabove. As we notice, the tribunal

on this score has also not scrutinized the dates appropriately, but has returned a cryptic finding.

34. In view of the aforesaid analysis, we are constrained to remit the matter to the tribunal for reconsideration of the aforesaid aspects on the basis of observations made hereinabove and the law in the field. However, we may proceed to state that we have not expressed anything on the merits of the case including the imposition of penalty and interest. We expect the tribunal shall advert to each and every facet in detail so that this Court can appropriately appreciate the controversy.

35. Resultantly, the appeal is allowed and the matter is remitted to the tribunal for fresh determination. There shall be no order as to costs.

.....J.
[Dipak Misra]

.....J.
[N.V. Ramana]

New Delhi;
January 05, 2017

Reportable

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 5003 OF 2006

Commissioner Central Excise, Bangalore ... Appellant(s)

Versus

M/s. United Spirits Ltd. & Anr. ... Respondent(s)

J U D G M E N T

Dipak Misra, J.

The respondent is a manufacturer of Indian Made Foreign Liquor (IMFL) and is a registered owner of several known brands of IMFL. The respondent, as the facts have been unfolded, also "manufactures" food flavours at its unit at Shayura Orchards, Kumbalagodu, Bangalore and the present appeal pertains only to food flavours.

2. The respondent has got its own distillery units at various places. In addition, it has entered into agreements

with various manufacturers of liquor who had their bottling plants and also appropriate licences to manufacture liquor. With these liquor manufacturers the respondent had entered into Usership Agreement whereby they were permitted to use the trademark of the respondent on IMFL manufactured by them on the terms and conditions mentioned in the agreement. The respondent had also entered into another agreement with the liquor manufacturers called the manufacturing agreement which provides for manufacture and sale by liquor manufacturers of IMFL under the respondent's brand names or its purchase by the respondent on the terms and conditions mentioned in the agreement. It is stipulated in the agreement that sale and purchase of IMFL under the agreement shall be on principal to principal basis. These liquor manufacturers were to purchase raw materials such as rectified spirit, extra neutral alcohol and blending and packing materials in accordance with the standards and specifications set forth in the agreement and from the approved suppliers. It was also provided in the manufacturing agreement that

modalities of price payable by the respondent to the liquor manufacturers for sale of IMFL and the price was to be the aggregate of cost of rectified spirit, extra neutral alcohol, blending and packing materials, storage, insurance premium and all manufacturing costs and expenses as mentioned in the agreement. In addition, the liquor manufacturers were entitled to the margin of profit called service charges in the agreement. The total price so paid to the liquor manufacturers was the sole consideration for the sales and such price is known as Ex-Distillery Price (EDP), which includes all costs, charges and expenses incurred by the liquor manufacturers for manufacture of IMFL as well as their margin described as service charges. The IMFL manufactured by liquor manufacturers was affixed with the brand names owned by the respondent. It provided the manufacturing logo, quality control, product research, etc. The respondent provided technical know-how/expertise to liquor manufacturers for manufacture of IMFL.

3. The liquor manufacturers sell IMFL manufactured by them either to the respondent or to the customers

identified by the respondent or to the government-owned corporations. The sales personnel of the respondent contact the customers, book orders, collect outstanding amounts from the market, collect statutory forms like C-Forms, Excise Verification Certificates, Permits, etc. and forward the same to the liquor manufacturers. The respondent would promote its brands through marketing teams and operation of various promotional schemes and advertisements and all expenses with regard to the same are incurred by the respondent. The liquor manufacturers were entitled to receive EDP which include the actual cost of IMFL manufactured by them plus the profit margin. The prices were negotiated by the respondent even when the goods were sold by the liquor manufacturers to such buyers and they would bill by such buyers at the rates negotiated and determined by the respondent.

4. The respondent, however, asserts that such rates/prices negotiated with outside buyers were either more or less than the EDP with certain consequences, namely, (a) if the selling price to outside customers is more than EDP, the difference was paid by the liquor

manufacturers to the respondent by calling it under different nomenclature like royalty or service charge; (b) if the selling price to outside customers was less than EDP, the difference/shortfall is borne by the respondent and paid to the liquor manufacturers; and (c) if the price realized from outside buyers is more than EDP, the difference accrued to the respondent.

5. As has been stated earlier, the respondent "manufactures" food flavours at its food flavour manufacturing unit at Bangalore. On the said aspect, the respondent asserts that the food flavours were "prepared" by mixing of various essences (odoriferous substances) purchased by the respondent from different suppliers.

6. Food flavours it is accepted play a role in the flavour profile of the liquor. Food flavours are not used in all brands of IMFL. There are certain brands of IMFL in which no food flavours are used and wherever they are used in IMFL, the percentage is very low ranging from 0.0001% to 00019% per litre. However, it is not the case of the respondent, that food flavours do not matter in the

IMFL business.

7. Food flavours were supplied by the respondent to their IMFL manufacturing units and also sold to liquor manufacturers who were manufacturing IMFL under manufacturing/usership agreements. Food flavours were also sold to third party manufacturers of IMFL. The liquor manufacturers under the manufacturing agreement would use food flavours in such proportions as identified by the respondent and the blending proportion was maintained as a trade secret of the respondent.

8. The respondent stands registered under the Central Excise Act, 1944 (for short, "the Act") for manufacture of food flavours falling under Sub-Heading No. 3302.10 of the Central Excise Tariff since 1994 and holds the Central Excise Registration Certificate No. 8/94. Food flavours manufactured by the respondent have been always cleared on payment of central excise duty. As a procedure, the respondent used to file price lists/declarations from time to time declaring the assessable value of food flavours in accordance with law. The assessable value included the

entire cost of raw material, labour cost, overheads and profit margin and were cleared from the factory on payment of central excise duty. The price of food flavours supplied to the respondent owned IMFL manufacturing units, liquor manufacturers and to other independent IMFL manufacturers, it is asserted by the respondent, did not vary and remain identical.

9. The royalty paid to the respondent by the liquor manufacturers, as asserted, is the difference between their selling prices of IMFL to outside buyers and the EDP of such IMFL. As pleaded, the payment of royalty has no nexus or connection with the food flavours. There are several brands of IMFL where no food flavour was supplied by the respondent to liquor manufacturers. However, royalty on the difference between the selling price of IMFL and EDP was still paid. The respondent claims that there were several instances where food flavours were sold and used in IMFL but no royalty was received. In those cases the selling price of IMFL was lower than the EDP and rather than receiving royalty, the respondent had borne the shortfall and reimbursed the same to liquor

manufacturers. On this ground, the respondent intends to put forth the stand that royalty was solely relatable to the higher selling prices of IMFL over and above EDP and has nothing to do with food flavour. The food flavours were not used in IMFL products like Signature Whisky, Centenary Whisky, Single Malt Whisky, etc. which were manufactured without using food flavours. In respect of the same, the liquor manufacturers manufacturing the said brand were paying royalty to the respondent, that being the difference between their selling price of the said brands and their EDP.

10. We have narrated the aforesaid factual scenario as substantially put forth by the respondent. At this juncture, it is necessary to state that revenue issued a show cause notice on 11.04.2000 on the ground that the respondent-assessee received additional consideration from its franchisees in the form of royalty for supplying food flavours which were essential ingredients of the IMFL manufactured by the franchisees. The proviso to Section 11A of the Act was invoked by the adjudicating authority and it was propose to re-determine the assessable value of

food flavours by including the royalty received by the assessee. The differential duty demanded for the period April, 1997 to March, 2009 was 35,45,865,860/-. Penalties were proposed on the unit and on the Senior Manager (Taxation) and interest was also levied. The adjudicating authority confirmed the demand vide his order dated 29.08.2002. The respondent approached the Customs, Excise and Service Tax Appellate Tribunal (for short, "tribunal") which in its order dated 08.07.2003 remanded the matter to the learned Commissioner as certain invoices of sales were produced before the tribunal which were not considered by the concerned Commissioner. While remitting the matter, the tribunal observed that as the matter was being remitted, the issue of limitation and such other issues were kept open for the adjudicator to re-determine and pass an appropriate order granting the opportunity to the parties for effective hearing. The issue of penalty was also kept open.

11. After the remit, the adjudicating authority passed an order on 27.02.2004. It placed reliance on the decision in ***Pepsi Foods Ltd. v. Collector of Central Excise,***

Chandigarh[51], and held that the royalty from the various units under the manufacturing agreement deserve to be included in the assessable value of the food flavour supplied to them and accordingly confirmed the demand under proviso to Section 11A of the Act. Equal amount of penalty was imposed under Section 11 AC and interest under Section 11AB was also levied. A penalty of Rs. 3,00,000/- was imposed on the Senior Manager (Taxation) under Rule 26 of the Central Excise Rules, 2002.

12. Before the tribunal, it was contended by the assessee that it purchased duty paid essences from various suppliers and simply mixed them by a process of manual mixing in the proportion developed by the respondent and which was kept as a top secret and the mere process of manual mixing of the essence did not amount to manufacture; that though the said issue was raised before the jurisdictional Assistant Commissioner on 18.02.2000 and a prayer was made to consider their plea that the food

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51 (2005) 9 SCC 28

flavour produced by them was not excisable and, pass an appropriate order, the concerned authority did not respond to the same and thereafter, the assessee informed the department that till a final decision was taken, the duty would be paid under protest. It is further contended that food flavours were odoriferous compounds and the quantum of food flavours used in IMFL wherever used were very negligible ranging from 0.0001% to 0.0019% per litre of various IMFL products and such use had no relevance in the marketability of IMFL product nor its final market price. Referring to the letters dated 18.02.2000 and dated 04.09.2001 wherein the assessee had taken a stand that mixing of duty paid flavours would not amount to manufacture. It reiterated the stand that it was not a manufacture on the basis of the decision rendered in ***Union of India & Ors v. Delhi Cloth and General Mills Co. Limited and Others***[52]. Reference was also made to the order passed by the Commissioner, Central Excise, Hyderabad who vide his letter dated 22.09.2003 had held that the mixing of duty paid food flavours could not result

[52] 1997 ELT (J199)SC

in emergence of a new product and the resultant essence which comes into existence in the premises of M/s. Shaw Wallace Co. (SWC) does not answer the test of marketability and as the facts are identical in the case of the assessee, the same should have been followed by the jurisdictional Commissioner. To bolster the said stand, reliance was placed on ***Delhi Cloth and Generals Mills Co. Limited (supra), South Bihar Sugar Mills Limited & Anr. Etc. v. UOI & Anr, Etc***[53]**,** and ***Tata Chemicals Limited v. R.M. Desai, Inspector, Central Excise, Mithapur & Others, Moti Laminates Private Limited v. CCE (SC)***[54], ***Kilpest India Limited v. CCE (Tri.)***[55]**,** ***XI Telecom Limited v. Supdt. Of Central Excise, Hyderabad(AP-DB)***[56]**,** and ***CCE v. Jagatjit Industries (SC)***[57].

13. It was further argued that in certain cases, the flavours which were not bought are not even mixed but were supplied directly to the bottlers, only the labels were changed in order to maintain secrecy and such an activity

[53] 1978 ELT (J 336)
[54] 1995 (76) ELT 241
[55] 1999 (108) ELT 786
[56] 1999 (105) ELT 263
[57] 2002 (141) ELT 306

could not be regarded as 'manufacture' inasmuch as under Chapter Heading 3302.10 re-labelling does not amount to manufacture. It was argued that mixing of flavours does not bring into existence a new product and even after mixing flavours, the resultant products still remains to be a flavour only. Attention of the tribunal was invited to Board's Circular No. 247/81/96-CX dated 03.10.1996 clarifying that mixing duty paid paints to obtain paint in different shade would not amount to manufacture. Further submission before the tribunal was that flavours were either mixed or supplied in the form in which they were purchased to the bottlers and cannot be marketed to anyone else and no other manufacturer would buy these flavours, for they were meant only for use in the product manufactured for the assessee.

14. Commenting on the nexus between the royalty and the price of food flavours, it was canvassed before the tribunal that the royalty and service charges were received by the assessee for use of the trade mark and for marketing services provided by it to the contract bottling units and even though flavours were supplied to

independent manufacturers, neither royalty nor service charges were received from them and hence, the royalty bill had no nexus with the price of the food flavour. That apart, it was argued that the assessee sold food flavours to Contract Bottling Units who employed them to manufacture IMFL products or to different other brand owners to whom they were paying royalty and service charges. However, the other brand owners paid only the price of flavours to the assessee and this would be indicative of the fact that the royalty had no nexus with the price of the flavours. Additionally, it was propounded that material was purchased before the concerned Commissioner showing that assessee had sold some kind of flavour to certain distilleries with whom there was no bottling agreement nor there was any receipt of royalty or service charges because the contract unit had not applied the brand of the assessee nor secured services of the assessee for marketing and in such a case, the Commissioner could not have asserted that the agreement was for sale of flavour and receipt of royalty and service charges. Reliance on the ***Pepsi Foods Ltd.*** (supra) was

seriously criticised before the tribunal as the ratio laid down was not applicable to the case at hand. Before the tribunal the learned counsel for the assessee had drawn attention that the manufacturing agreement and usership agreement to highlight certain aspects, to draw distinction and the adjudicating authority could not have proceeded to allocate the entire receipts to the value of food flavours alone without any basis. Criticising the invocation of the jurisdiction under Section 11A of the Act, it was contended that there was no suppression on the part of the appellants as the factum of payment of royalty was known to the department and it was clear from the note of the Range Officer to the Deputy Commissioner which clearly laid down that the amount paid towards royalty was only for use of the brand name for sale of flavour and prior to the issue of show cause notice, there was an audit inspection on 28.03.2001 and the assessee was asked to clarify various points raised which had been clarified vide letter dated 28.04.2001 and all these aspects had not been taken into consideration while invoking the jurisdiction. It was also put forth that as royalty had no nexus with the

price of food flavours, the assessee was not expected to declare it and, therefore, it could not be treated as suppression. That apart, at the time of audit objection even the Range Superintendent was of the view that there was no nexus between the royalty received by the appellant and the price of food flavours sold by the assessee and, therefore, in the obtaining circumstances, the notices were clearly barred by time.

15. The stand and stance put forth by the assessee was controverted by the revenue contending, *inter alia*, that the department had raised the question of excisability of the product in question, when it found the modification of stay order Nos. 838 and 839/2004 dated 10.08.2004 by the High Court. It was also urged that there was an earlier proceeding in 1995 relating to food flavour and the case was adjudicated by the then Commissioner, consequent upon which the assessee had started paying duty and hence, excisablity of the product in question was never an issue at all as the conduct of the assessee would reflect. Reference was made to Entry 3302 in the Tariff and 3302.10 to highlight that the tariff itself recognizes

mixtures of odoriferous substances as excisable product and, hence, it could not be said that no manufacture was involved in the mixing of the essences to produce such food flavours. It was urged that goods to fit into the term 'manufacture' must be capable of being bought and sold in the market and to be known as such. In that regard, placing reliance on ***Bhor Industries Ltd v. CCE, Bombay***[58], ***Union Carbide v. CCE***[59], ***Moti Laminates Pvt. Ltd. & Ors v. CCE, Ahmedabad***[60], ***Union Of India & Others v. Sonic Electrochem (P) Ltd. and another***[61] and ***CCE, Chandigarh-II v. Jagatjit Industries Ltd.***[62], it was canvassed that in the case at hand the food flavours manufactured by the assessee were marketable as evidenced from the assesse's admissions that it has been selling food flavours to other independent bottlers who were not manufacturing the IMFL brands of McDowell but their own brands which establish marketability of the product. It was further argued that the inputs were essences and once they were mixed or prepared, they lost

[58] (1989) 1 SCC 602
[59] 1986 (24) ELT 169 (SC)
[60] (1995) 3 SCC 23
[61] (2002) 7 SCC 435
[62] (2002) 3 SCC 614

their original identity. It was also urged that though the input and finished goods were under the same tariff heading, still there was manufacture and the finished goods were having distinct, separate and identifiable function, with reference to the product, i.e., IMFL. The further stand was that mixing amounts to manufacture as has been laid down in ***Gopal Zarda Udyog v. CCE, New Delhi***[63], ***O.K. Play (India) Limited v. CCE, New Delhi II***[64], ***Nestle India Limited v. CCE, Chandigarh II***[65], ***T.N. State Transport Corporation Limited v. CCE, Madurai***[66], ***Kothari Products Limited v. Government of Andhra Pradesh***[67], ***CCE, Guntur v. Crane Betel Nut Powder Works***[68], and ***Henna Export Corporation v. CCE***[69]. The revenue further contended that as per Section 4 of the Act, the assessable value depends on the nature of transaction and each price in a transaction was an assessable value and it cannot be compared if the type of transaction was different. The assessee received royalty

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[63] 2005 (188) ELT 251 (SC)
[64] 2005 (180) ELT 291 (SC)
[65] 2004 (169) ELT 315 (Tri-Del)
[66] 2004 (166) ELT 433 (SC)
[67] 1998 (98) ELT 315 (AP)
[68] 2005 (187) ELT 106 (Tri-Bang)
[69] 1993 (67) ELT 907 (Tribunal)

charges from buyers who were contract bottling units and separate assessable value was computable for these types of customers and in such cases, the royalty charged by the assessee from the buyers has to be treated as additional consideration.

16. After noting down the submissions of the learned counsel for the parties, the tribunal adverted to the issue of nexus between the royalty and the price of food flavours. The tribunal clearly stated that in the year 1995, the department had proceeded against the assessee for non-payment of central excise duty on the food flavours produced by them and the Commissioner confirmed the demands raised and at that time, the excisability of food flavours was not questioned by the assessee. After the adjudication order dated 30.01.1995, the assessee was clearing the goods on payment of duty. During 2001, the departmental audit raised certain objections with reference to the receipt of certain amounts towards royalty, service charges, etc. from the contract bottling units engaged in the manufacture of IMFL and according to the audit, the royalty charges should be added to the value of the food

flavour sold to the contract bottling units. At that juncture, the assessee gave justification for non-inclusion of royalty charges. The tribunal, as the impugned order would reflect, has adverted in detail to the justification given by the assessee before the adjudicating authority which was basically founded on the conditions set out in the agreement that royalty was payable by the manufacture for use of the brand name and that the royalty had no relevance with the goods or various inputs that go into the manufacture of these goods. It was also set forth that the brands of the company had their own value and the royalty receivable from the manufacturer was primarily on account of company's brands of finished goods, namely, IMFL viz. No. 1 Brandy, No. 1 Whisky, Diplomat Whisky, Premium Whisky, Dry Gin, etc. It was also contended that the audit party had erroneously mis-interpreted the concept of royalty as one which was capable of being subdivided into and allocable to various manufacturing inputs, for it is neither feasible nor a correct procedure to apportion the royalty which was accruing to the company on the company's brand image.

It was also contended that such an understanding would defeat the purpose of the agreement. Though such a stand was explained by the assessee, yet the department was of the view that the royalty should be added to the assessable value and consequently first show cause notice dated 11.04.2002 was issued. The tribunal thereafter chronologically analysed the facts and order of remit and the *de novo* order and perused the relevant agreements of the appellants with the CBUs. On scrutiny of the agreements, the tribunal found that there were two agreements, one is called the Manufacturing Agreement and the other is Usership Agreement. As per the terms and conditions of the agreement, the products were to be manufactured by the second party would include the products whose trade mark was owned by the assessee-appellant before the tribunal and any other associate company of it. The second party to the agreement was required to purchase blending and packing materials from such suppliers specified by the assessee and above condition was for the purpose of ensuring quality specification. The agreement defined the blending

material. The tribunal referred to the definition of "Blending Material" and opined that the said definition includes food flavours. It referred to para 18 of the agreement which stipulates that during the currency of the agreement, the second party (as pointed out by the tribunal) Gemini Distilleries (Tripura) Pvt. Ltd. (GDPL) shall not use trade mark to or adopt any trade mark similar to any of the trade marks on or in connection with any product. On that basis, the tribunal opined that on careful reading of the agreement reveals that the assessee has good control over the manufacture of IMFL by GDPL and it ensures the quality of the product, which bears the trade mark of the assessee. Referring to the usership agreement, the tribunal observed that the proprietor was the assessee and the user was GDPL and according to the said agreement, at the request of the user, the proprietor had agreed to permit the user to use the trade marks in respect of the goods on the terms and conditions mentioned in the agreement. The tribunal referred to para 12 of the agreement which postulates that in consideration of this licence, the user shall pay to the proprietor such

sum per case manufactured of the goods as may be mutually agreed upon by the parties from time to time and the consideration shall be paid by the user by the following month. It further observed that though the word royalty has not been used in the agreement, it was clear that the sum mentioned in para 12 of the agreement refers to royalty and the royalty was for the use of trade mark and there was no indication whatsoever to infer that the royalty was paid for supply of food flavour. It took note of the fact that food flavour was one of the blending materials and not the sole blending materials sold by the assessee to the CBU and hence, *prima facie*, there does not appear to be any close nexus between royalty and the food flavour.

17. Be it noted, the assessee before the tribunal highlighted that there were three types of transactions, namely, receipt of royalty and also supply of food flavours; royalty was received though there was no supply of food flavours; and royalty was not received even though there was supply of food flavours. Accepting the said submission, the tribunal held thus:-

"The appellants took us through the various documents and showed us that there is practically no difference in price in respect of sales to independent buyers and the prices at which food flavours are sold to CBUs. This fact clinches the issue. It is very clear that there is no nexus between the royalty and the food flavours. The adjudicating authority has relied on the Apex Court's decision in the Pepsi case. In our view, the ratio of the above decision should not have been blindly applied as done by the adjudicating authority. In the Pepsi case, both the concentrate and the final product are excisable which is not the case in the present appeals. The final product here is IMFL for which royalty is paid. IMFL is not subjected to Central Excise duty. In the Pepsi case, the concentrate is the most essential ingredient of Pepsi Cola whereas in the present case, it is not so. There are certain brands of IMFL which do not require any food flavour. In the Pepsi case, the concentrates are sold only for the franchisees. In the instant case, the appellants have sold food flavours to independent manufactures of IMFL who will not be using the brand name of the appellants. Such independent manufacturers would not pay any royalty. In the Pepsi case, an express prohibition restricting the bottlers to purchase the concentrate from any other source was there. No such express prohibition is there in the present agreement. It was further pointed out by the appellants that there are instances wherein the appellants have paid an amount to bottlers when the sale price of IMFL is much below the ex-distillery price. It is further seen that apart from food flavour, the appellants supplied other blending materials to these CBUs. In these circumstances, the entire royalty paid cannot be attributed to the food flavour whose cost is only 0.45% according to the appellants. Further we find that even in 2001, at the time of audit inspection, the appellants have taken a firm stand not only regarding the includibility of royalty but also the

> question of very excisability of the food flavour itself. In these circumstances, there is no justification for alleging suppression of facts to invoke the larger period. Hence the Show Cause Notice dated 11.04.2002 and 08.03.2004 are clearly time barred. For the above mentioned reasons, the royalty has no nexus with the price of the food flavour and hence, not includible in the assessable value. Moreover, the first two Show Cause notices are time barred as there is no suppression of facts."

18. After so stating, the tribunal addressed the issue pertaining to excisability of food flavours. It took note of the fact that there was purchased duty paid odoriferous compounds called essences and these essences were mixed manually to obtain food flavour. In what proportion and which essences were to be mixed has been kept a trade secret and different brands of IMFL require food flavour of different profiles. In order to ensure the quality consistency in the various brands of IMFL, the production of food flavour was centralized at Bangalore which does not use power. The tribunal referred to Board's circular dated 22.11.1999 wherein it has been clarified that agarbati manufacturing process involving simple mixing of a few aromatic chemicals with the base oil in a container in liquid form, which was mixed directly with the dough or

applied on agarbati in the required proportion used for rolling of agarbati is not excisable product and, therefore, no duty was leviable on such compounds during the course of manufacture of agarbati. It was urged before the tribunal that the fact situation in the case of assessee was similar, as has been clarified in the Board's circular in respect of agarbati. It is further urged that there was a simple mixing of essences of different flavour profile and the food flavours produced by the assessee are exclusively used for making their brands of IMFL in their own units and contract units and it cannot be sold in the market as such. The tribunal posed a question whether the process of mixing of essences results in a distinct commodity, which was different from the original inputs. In that context, it held thus:-

> "We find that both the essences and the resultant product food flavour fall under the same Tariff Heading. Since different proportion of the ingredients give different flavours to the resultant product, we cannot say that a ingredients give different flavours to the resultant product, we cannot say that a completely distinct product emerges. The comparison with agarbathi mention in Board's Circular is justified. Board's Circular dated 03.11.1996 deals with the process of tinting of duty paid base white Paint with duty paid

strainer to obtain paint of different shades. It has been clarified that the above process does not amount to manufacture on the ground that the process of tinting does not bring about any new commodity with different commercial identity as the resultant emulsion/enamel point and hence, it may not be appropriate to consider this process as amounting to manufacture. While clarifying the above position, the Board has applied the ratio of the classic judgment of the Apex Court in the DCM case wherein it has been held that "Manufacture implies change, but every change is not manufacture and yet every change in an article is a result of treatment, labour and manipulation, but something more is necessary and there must be transformation; a new and different article must emerge having distinctive name, character and use."

In another Circular dated 13.07.1992, the Board has clarified that conversion of plain plastic granules into coloured plastic granules would not amount to manufacture.

In all these cases, the commercial identify of the ingredients and the finished product remained the same. In the present case also, the process of mixing two or more essences in certain proportions does not bring into existence any new product. The essence remained essences only and because of the different proportion, a distinct flavour is imparted to the resultant product. That cannot make the process as manufacture."

19. To arrive at the said conclusion, it placed reliance on ***CCE Chennai v. Fountain Consumer Appliances Limited***[70], ***Tega India Limited v. CCE, Calcutta II***[71],

[70] 2004 (171) ELT 329 (Tri-Chennai)
[71] (2004) 2 SCC 727

State of Maharashtra v. Mahalaxmi Stores[72], and ***CCE Chennai v. Titanium Equipment & Anode Manufacturing Co. Ltd.***[73]

20. We have heard Mr. Yashank Adhyaru, learned senior counsel for the appellant and Ms. Indu Malhotra and Mr. S.K. Bagaria, learned senior counsel for the respondents. It is submitted by the learned counsel for the appellant that the final product 'food flavour' is classified under Chapter Heading 3302.10 and hence is excisable and dutiable. According to him, the assessee itself had admitted that it was selling the food flavours to independent bottling units and that establishes the marketability of the product. The assessee had claimed that its product is custom made and the formula is a trade secret and further it had availed CENVAT credit of inputs for payment of duty on final product. As the facts had been established, contend Mr. Adhyaru, the finished goods are sold on different code numbers assigned by the assessee, hence a new identity is established. Learned senior counsel would urge to construe a particular good

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[72] (2003) 1 SCC 70
[73] 2002 (142) ELT 162 (Tri-Chennai)

has been manufactured, the goods must be capable of being bought and sold in the market, as has been held by this Court in ***Bhor Industries Ltd.*** (supra), ***Jagatjit Industries Ltd.*** (supra) and ***Servo Med Industries Pvt. Ltd. v. CCE***[74]. Learned senior counsel would contend that mixing which is prefixed by simple fixing by the assessee is not acceptable because the process of mixing can amount to manufacature as has been held in ***Gopal Zarda Udyog*** (supra) and ***O.K. Play (India) Limited*** (supra). As far as the royalty is concerned, it is urged by him that the assessee had received royalty charges from buyers who are contract bottling units and separate assessable value is computable for this type of customers.

21. In the instant case, as the revenue would put forth, the royalty/service charge received by the assessee under the various agreement with other manufacturers of IMFL forms additional consideration and is includible in the assessable value under Section 4 of the Act read with Valuation Rules as has been held in ***Pepsi Foods Ltd.*** (supra).

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[74] 2015 (6) SCALE 137

22. Mr. Bagaria and Ms. Indu Malhotra, learned senior counsel appearing for the assessee in their turn would contend that the food flavours were odoriferous compounds and are prepared by way of simple mixing of various essences (odoriferous substances) purchased from different suppliers and thus the food flavours that were obtained from simple mixing of duty paid essences/flavours done manually cannot be regarded as manufacture, for by such mixing no new commodity having existing name, character or use emerges. That apart, in around 26% of the cases even such mixing was not done and the flavours purchased from the market were cleared as such merely after relabeling and when flavours fall under the Heading No. 3302.10, no extended meaning is to be given to the expression 'manufacture'. Reliance has been placed on circular no. 247/81/96-Cx. dated 03.10.1996 issued by CBEC, Ministry of Finance, Government of India, which had clarified that the process of tinting of base emulsion/enamel paint with strainers to obtain paint of different shades does not amount to 'manufacture' within the meaning of Section 2(f) of the Act.

It was their further submission that tribunal has rightly made the comparison between the process of tinting of base emulsion/enamel paint with strainers with the process of mixing two or more essences in certain preparation to arrive at the conclusion that no process of manufacture was involved in the case of the assessee. It was urged that it is well settled that mere mention of the goods in one of the Entries in the schedule to the Central Excise Tariff would not render them exigible to excise duty unless the twin tests of manufacture and marketability were satisfied. It has also been repeatedly held that manufacture implies a change but every change was not manufacture and in order to attract the concept of manufacture, there must be transformation of the raw materials into a new and different article having a distinctive name, character and use. In that regard reliance has been placed on ***Union of India v. Ahmedabad Electricity Co. Ltd & others.***[75], ***Hindustan Zinc Ltd. v. CCE, Jaipur***[76], ***Delhi Cloth & General Mills*** (supra) and ***Satnam Overseas Ltd. v. CCE, New Delhi***[77].

[75] (2003) 11 SCC 129
[76] (2005) 2 SCC 662
[77] (2015) 13 SCC 166

It has been emphatically put forth that a simple process of mixing do not amount to manufacture as there is no transformation of the inputs into any new or differential commodity and for the said proposition, reliance has been placed on ***CCE, Bangalore-II v. Osnar Chemicals Private Ltd.***[78], ***CCE, Meerut v. Goyal Gases (P) Ltd.***[79] and ***Crane Betel Nut Powder Works v. Commr. of Customs & Central Excise, Tirupathi***[80]. Further stand of the respondent is that in respect of the Sub-Heading 3302.10 which covers food flavours, no artificial or extended meaning has been given to the expression 'manufacture' by the legislature by exercising the power under Section 2(f)(iii) and hence, it cannot be regarded as manufacture. Heavy reliance is placed on the decisions in ***Shyam Oil Cake Ltd. v. CCE-I, New Delhi, Jaipur***[81] and ***CCE v. S.R. Tissues (P) Ltd.***[82] As far as the stand of the revenue that the assessee at one point of time had accepted the process of mixing and manufacture and paid the duty under the specified heading, it would debar the

[78] (2012) 2 SCC 282
[79] (2000) 9 SCC 571
[80] (2007) 4 SCC 155
[81] (2005) 1 SCC 264
[82] (2005) 6 SCC 310

assessee to raise the plea again is sans substance as the Commissioner himself had admitted that food flavours were prepared by simple manual mixing of odoriferous substances but by the assessee. That apart, the assessee was entitled to raise such an issue in respect of the subsequent period and is not stopped to do so in view of the decision in ***Municipal Corporation of City of Thane v. Vidyut Metallics Ltd.***[83] As far as the conclusion arrived at by the tribunal that two show cause notices dated 11.04.2002 and 30.04.2004 are barred by limitation, no fault can be found with it inasmuch as the said show cause notices were issued after expiry of one year from the period covered thereunder and hence, plea barred by limitation as provided under Section 11A(1) of the Act. As regards the limitation, learned senior counsel for the respondent have drawn inspiration from ***Cosmic Dye Chemical v. CCE, Bombay***[84], ***Padmini Products v. CCE, Bangalore***[85], ***Pushpam Pharmaceuticals Co. v. CCE, Bombay***[86] and ***Uniworth Textiles Ltd. v. CCE,***

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[83] (2007) 8 SCC 688
[84] (1995) 6 SCC 117
[85] (1989) 4 SCC 275
[86] 1995 Supp (3) SCC 462

Raipur[87]. As far as penalty imposed under Section 11AC is concerned, it is urged that there has been no fraud or collision or wilful mis-statement or suppression of facts or contravention of provisions of the Act or the Rules with the intention to evade payment of duty and, therefore, the authorities could not have mechanically imposed the penalty and the tribunal is absolutely justified in setting aside the same.

23. From the factual narration and the submissions advanced at the Bar, we find three issues, namely, (i) whether there was 'manufacture', (ii) whether there was nexus in royalty received and the price paid for the food flavour sold, and (iii) whether two show cause notices have been correctly determined to be barred by limitation by the tribunal. First we shall advert to the issue of 'manufacture'. The submission of the respondent is that they are mixing essences and in some cases merely selling food flavours purchased from third parties without any processing and in any case mixing of essences under no circumstances can amount to manufacture. The said

[87] (2013) 9 SCC 753

submission is founded on the principle that by such process of mixing change takes place and no separate and marketable commodity comes into existence. Various judgments have been cited at the Bar to explain the term 'manufacture'. It is well settled in law that 'manufacture' implies change, but every change is not manufacture, such change is normally a result of treatment, labour and manipulation. In this regard, we think it appropriate to to reproduce a passage from ***Union of India v. Delhi Cloth & General Mills Co. Ltd.***[88] wherein the Constitution Bench quoted with approval from an American judgment in ***Anheuser-Busch Brewing Assn. v. United States***[89], which is to the following effect:-

> "'Manufacture' implies a change, but every change is not manufacture and yet every change of an article is the result of treatment, labour and manipulation. But something more is necessary and there must be transformation; a new and different article must emerge having a distinctive name, character or use."

24. In ***Deputy Commissioner of Sales Tax (Law), Board of Revenue (Taxes), Ernakulam v. Pio Food***

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[88] AIR 1963 SC 791
[89] 207 US 556 (1908)

Packers[90], a three-Judge Bench while interpreting Section 5-A(1)(a) of the Kerala General Sales Tax Act, 1963 opined that:-

> "There are several criteria for determining whether a commodity is consumed in the manufacture of another. The generally prevalent test is whether the article produced is regarded in the trade, by those who deal in it, as distinct in identity from the commodity involved in its manufacture. Commonly manufacture is the end result of one more processes through which the original commodity is made to pass. The nature and extent of processing may vary from one case to another, and indeed there may be several stages of processing and perhaps a different kind of processing at each stage. With each process suffered, the original commodity experiences a change. But it is only when the change, or a series of changes, take the commodity to the point where commercially it can no longer be regarded as the original commodity but instead is recognised as a new and distinct article that a manufacture can be said to take place. Where there is no essential difference in identity between the original commodity and the processed article it is not possible to say that one commodity has been consumed in the manufacture of another. Although it has undergone a degree of processing, it must be regarded as still retaining its original identity."

25. After so stating, the Court posed the question: does the processing of original commodity brings into existence a commercially different and distinct article? In that context, the three-Judge Bench analysed the ratio in

[90] 1980 Supp. SCC 174

previous decisions and stated thus:-

> "Some of the cases where it was held by this Court that a different commercial article held come into existence include *Anwarkhan Mahboob Co.* v. *State of Bombay*[91] (where raw tobacco was manufactured into bidi patti), *A. Hajee Abdul Shakoor and Co.* v. *State of Madras*[92] (raw hides and skins constituted a different commodity from dressed hides and skins with different physical properties), *State of Madras* v. *Swastik Tobacco Factory*[93] (raw tobacco manufactured into chewing tobacco) and *Ganesh Trading Co., Karnal* v. *State of Haryana*[94], (paddy dehusked into rice). On the other side, cases where this Court has held that although the original commodity has undergone a degree of processing it has not lost its original identity include *Tungabhadra Industries Ltd., Kurnool* v. *CTO*[95], (where hydrogenated groundnut oil was regarded as groundnut oil) and *C.S.T., U.P., Lucknow* v. *Harbilas Rai and Sons*[96] (where bristles plucked from pigs, boiled, washed with soap and other chemicals and sorted out in bundles according to their size and colour were regarded as remaining the same commercial commodity, pigs bristles)."

26. Adverting to the fact situation which pertained to pineapple fruit and canned pineapple slices, the Court held:-

> "In the present case, there is no essential difference between pineapple fruit and the canned pineapple

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91 AIR 1961 SC 213
92 AIR 1964 SC 1729
93 AIR 1966 SC 1000
94 (1974) 3 SCC 620
95 AIR 1961 SC 412
96 (1968) 21 STC 17 (SC)

slices. The dealer and the consumer regard both as pineapple. The only difference is that the sliced pineapple is a presentation of fruit in a more convenient from and by reason of being canned it is capable of storage without spoiling. The additional sweetness in the canned pineapple arises from the sugar added as a preservative. On a total impression, it seems to us, the pineapple slices must be held to possess the same identity as the original pineapple fruit."

27. In ***Collector of Customs, Bombay v. S.H. Kelker & Co. Ltd.***[97], the assessee had imported an organic chemical "abbalide" which the assessee had classified under Chapter 29 and not as an odoriferous substances under Heading 33.02 of the tariff. Reversing the judgment of the tribunal, it was held by the Court as under:-

> "10. Heading 33.02 of the Tariff refers to
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> "mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in industry".
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> It envisages (*i*) mixtures of odoriferous substances, and (*ii*) mixtures (including alcoholic substances) with a basis of one or more of odoriferous substances and the mixtures are of a kind used as raw materials in industry. In the present case, it has been found that the chemical, in its original form, consists of various isomers and is an odoriferous substance. It has been dissolved in diethyl phthalate, a non-odoriferous substance. The odoriferous

[97] (2000) 10 SCC 478

substance is the basis of the mixture. It is not disputed that the mixture is used as a raw material, viz., perfume in industry. It can, therefore be said that the compound is a mixture with a basis of an odoriferous substance and since it is for use as a raw material in industry, it would be classifiable under Heading 33.02.

11. In our opinion, the Tribunal was in error in construing clause 1(*e*) of Chapter 29 and in holding that the said product was classifiable under Chapter 29. Clause 1(*e*) of the Notes in Chapter 29 postulates that if a product mentioned in sub-clauses (*a*), (*b*) or (*c*) of clause 1 is dissolved in a solvent and the solution constitutes a normal and necessary method of putting up these products adopted solely for the reasons of safety or for transport then the product would fall within Chapter 29 only if the solvent does not render the product particularly suitable for specific use rather than for general use. As per the certificate dated 19-9-1986 issued by the manufacturer the compound imported by the respondents cannot be used in the condition it is manufactured and for making it suitable for use and for retaining its suitability for use it has to be dissolved in a solvent. The need of a solvent is not only for the purpose of storage and transport of the chemical, but also for retaining the suitability of the product after it is manufactured. Its dissolution in the solvent is necessary in order to make the product suitable for use. Since the product is used only for perfumery and not for any other purpose, it has to be held that the product is intended for specific use only. In view of clause 1(*e*) of the Notes in Chapter 29, it may be held that the product imported by the respondents cannot be regarded as falling under Chapter 29 of the Tariff and would fall under Heading 33.02 in Chapter 33 of the Tariff. We are, therefore, unable to uphold the impugned judgments of the Tribunal."

28. We have referred to the decisions to highlight the concept of essential change in the character of the product. In this regard, useful reference may be made to the authority in ***Income Tax Officer, Udaipur v. Arihant Tiles and Marbles Pvt. Ltd.***[98], the Court after referring to ***CIT v. M/s N.C. Budharaja and Company***[99], opined thus:-

> "25. Applying the above tests laid down by this Court in *Budharaja case* to the facts of the present cases, we are of the view that blocks converted into polished slabs and tiles after undergoing the process indicated above certainly results in emergence of a new and distinct commodity. The original block does not remain the marble block, it becomes a slab or tile. In the circumstances, not only is there manufacture but also an activity which is something beyond manufacture and which brings a new product into existence and therefore, on the facts of these cases, we are of the view that the High Court was right in coming to the conclusion that the activity undertaken by the respondent assessees did constitute manufacture or production in terms of Section 80-IA of the Income Tax Act, 1961.
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> 26. Before concluding, we would like to make one observation. If the contention of the Department is to be accepted, namely, that the activity undertaken by the respondents herein is not manufacture, then, it would have serious revenue consequences. As stated above, each of the respondents is paying excise duty, some of the respondents are job-workers and the activity undertaken by them has been

[98] (2010) 2 SCC 699
[99] 1994 Supp (1) SCC 280

> recognised by various government authorities as manufacture. To say that the activity will not amount to manufacture or production under Section 80-IA will have disastrous consequences, particularly in view of the fact that the assessees in all the cases would plead that they were not liable to pay excise duty, sales tax, etc. because the activity did not constitute manufacture."

29. At this juncture, it is obligatory to state that revenue has heavily relied upon on ***Pepsi Foods Ltd.*** (supra). In the said case the Court had found that the consideration payable as royalty was an inevitable consequence of the sale of the concentrate and in such circumstances the price paid for the concentrate was not the sole consideration paid by the purchaser. The terms of agreement had obligated the bottler to purchase the concentrate from the assessee alone, use the assessees' trade mark on the bottled beverage and also pay royalty for assessees' trade mark at the specified percentage of the maximum retail price of each bottle. In the given circumstances and evidence available, it was held that the price actually paid for sale of concentrate was not to be the determinative factor as the price paid for the sale of concentrate, i.e., invoice would not be determinative, as

the royalty payment was inseparably linked with the sale consideration paid for the concentrate. The indelible nexus and connect was established to club the two considerations.

30. The respondent, in its turn, has placed reliance on ***Shyam Oil Cake Ltd.*** (supra) and contended that mere separate tariff entry is not indicative whether the same amounts to manufacture, for tariff entry can be merely for the purpose of identifying the product and the rate applicable to it. In such case, it would not have the effect of rendering the specified commodity to be excisable. Section 2(f) defines "manufacture" and by deeming effect, a process can amount to manufacture. Albeit, for a deeming provision to come into play, it must be specifically stated that a particular process amounts to manufacture. The respondent has also placed reliance on Circular no. 495/61/99-CX-3 dated 22nd November, 1998, but the said circular relates to compound preparation during the course of manufacture of agarbati. In the context of the said product, clarification was issued. It is noticeable that the respondent had pleaded a different factual matrix

which has been accepted by the tribunal, albeit, without referring to specific details. General observation and broad brush approach need not reflect true consideration paid for all transactions. A far greater and deeper scrutiny of facts is required before forming any opinion, one way or the other. It would be wrong to be assumptuous without full factual matrix being lucent and absolutely clear.

31. Recently, in ***The Additional Commissioner of Commercial Taxes, Bangalore v. Ayili Stone Industries Etc. Etc.***[100] the Court was dealing with the issue of grant of exemption on polished granite stone and the view of the revenue that the polished and unpolished granite stones are under separate Entries in the second schedule to the Karnataka Sales Tax Act, 1957. The question arose before this Court pertained to interpretation of polished and granite stones and in that context the concept of manufacture and after referring to various judgments, it held that:-

> "28. There is a distinction between polished granite stone or slabs and tiles. If a polished granite stone is used in a building for any purpose, it will come under Entry 17(i) of Part S of the second schedule,

[100] Civil Appeal Nos. 1983-2039 of 2016 dated 18.10.2016

> but if it is a tile, which comes into existence by different process, a new and distinct commodity emerges and it has a different commercial identity in the market. The process involved is extremely relevant. That aspect has not been gone into. The Assessing Officer while framing the assessment order has referred to Entry 17(i) of Part S but without any elaboration on Entry 8. Entry 8 carves out tiles as a different commodity. It uses the words "other titles". A granite tile would come within the said Entry if involvement of certain activities is established. To elaborate, if a polished granite which is a slab and used on the floor, it cannot be called a tile for the purpose of coming within the ambit and sweep of Entry 8. Some other process has to be undertaken. If tiles are manufactured or produced after undertaking some other activities, the position would be different. A finding has to be arrived at by carrying out due enquiry and for that purpose appropriate exercise has to be undertaken. In the absence of that, a final conclusion cannot be reached."

32. In the case at hand, as we find from the order of the tribunal the exact nature of the process undertaking and how mixing is undertaken and the process involved is not discernible and has not been ascertained and commented. It remains ambiguous and inconclusive. The respondent claims that about 26% of the sales of odoriferous substances were brought from third party and sold without any modification or process. These are all questions of fact which must be first authenticated and

the actual factual position validated. The tribunal has answered the question in favour of the respondent without the background check as to the actual process involved and undertaken. Different flavours may have different processes.

33. The third issue relates to the issue of limitation. The tribunal has held that certain show cause notices are barred by limitation. Mr. Bagaria, learned senior counsel has submitted that the said conclusion is absolutely flawless, if the dates are taken into consideration. For the aforesaid purpose, he has commended us to the decision already referred to hereinabove. As we notice, the tribunal on this score has also not scrutinized the dates appropriately, but has returned a cryptic finding.

34. In view of the aforesaid analysis, we are constrained to remit the matter to the tribunal for reconsideration of the aforesaid aspects on the basis of observations made hereinabove and the law in the field. However, we may proceed to state that we have not expressed anything on the merits of the case including the imposition of penalty

and interest. We expect the tribunal shall advert to each and every facet in detail so that this Court can appropriately appreciate the controversy.

35. Resultantly, the appeal is allowed and the matter is remitted to the tribunal for fresh determination. There shall be no order as to costs.

.....J.
[Dipak Misra]

.....J.
[N.V. Ramana]

New Delhi;
January 05, 2017

ITEM NO.1A COURT NO.2 SECTION IIIB

S U P R E M E C O U R T O F I N D I A
RECORD OF PROCEEDINGS

Civil Appeal No(s). 5003/2006

COMMISSIONER CENTRAL EXCISE Appellant(s)

VERSUS

M/S.UNITED SPIRITS LTD.& ANR. Respondent(s)

Date : 05/01/2017 This appeal was called on for judgment today.

For Appellant(s) Mr. B. Krishna Prasad,Adv.

For Respondent(s) Mr. Prashant Singh, Adv.
Mr. Tanvir Nayar, Adv.
Mr. Vikas Mehta, AOR

Hon'ble Mr. Justice Dipak Misra pronounced the judgment of the Bench consisting of His Lordship and Hon'ble Mr. Justice N.V. Ramana.

The appeal is allowed and the matter is remitted to the tribunal for fresh determination in terms of the signed reportable judgment. There shall be no order as to costs.

(Gulshan Kumar Arora)
Court Master

(H.S. Parasher)
Court Master

(Signed reportable judgment is placed on the file)