(2014) 08 DEL CK 0302

In the Delhi High Court

Case No : W.P.(C) 818/2014, CM Appl.1650 & 4321/2014

Reddys Laboratories Ltd. APPELLANT

Vs

Union of India RESPONDENT

Date of Decision : 14-08-2014

Acts Referred:
Central Excises and Salt Act, 1944 — Section 1(2), 11B, 35E(2), 35EE, 4
Companies Act, 1956 — Section 233B
Customs Act, 1962 — Section 14

Citation : (2014) 309 ELT 423 : (2015) 31 GSTR 93

Hon'ble Judges : Vibhu Bakhru, J;S. Ravindra Bhat, J

Bench : Division Bench

Advocate : S. Ganesh, Sr. Advocate, Neelima Tripathi and Saraswata Mohapatra, Advocate for the Appellant; Girish Pande and Ravinder Agarwal, Advocate for the Respondent

Judgement

S. Ravindra Bhat, J.—This petition relates to two rebate claims of Rs. 21,18,36,117 and Rs. 1,75,57,537, made on 18.7.2011 and 14.11.2011 respectively, under the Central Excise Act, 1944 ("the Central Excise Act") before the Deputy Commissioner of Customs and Central Excise. The petitioner, Dr. Reddys Laboratories Ltd. ("Dr. Reddys"), claimed this rebate for refund of excise duty paid earlier by it on the export of certain pharmaceutical products. The refund was allowed by the Deputy Commissioner (by two orders dated 30.9.2011 and 13.1.2012). Dr. Reddys was refunded the amounts. Later, proceedings were initiated before the Commissioner of Customs, Central Excise and Service Tax (Appeal II) for recovery of the refunded amount, on the ground that the rebate amounts refunded were in excess. It is in this background that the present petition has come before this Court.

2. The brief facts are that during the export period under consideration, Dr. Reddys was granted the exclusive right to sell the drug Olanzapine, in 5, 10 and 20 mg formulations, in the United States (US) for a limited period of 180 days. Between October 2011 and January 2012, Dr. Reddys exported the drug to its US

subsidiary, Dr. Reddys Laboratories Inc., New Jersey, USA ("the Jersey subsidiary") at a price of US $ 7, 3.65 and 2.20 for the 20, 10 and 5 mg tablets respectively, amounting to a total of approximately Rs. 411 crores through foreign exchange, which was received in India. According to that valuation, Dr. Reddys paid excise duty at the applicable rate of about 5% of Rs. 21,18,36,11 on the 20 mg tablets, and Rs. 64,66,041 on the 5 and 10 mg tablets. A rebate application was then made since excise duty on exported products is nil under Rule 18 of the Central Excise Rules, 2002 ("2002 Rules"). The rebate claimed was granted.

3. Proceedings were later initiated before the Commissioner (Appeals) for partial recovery of the rebate, after the Commissioner exercised powers of review u/s 35E(2) of the Act and passed orders for the filing of an appeal. In these proceedings, the Appellate Commissioner held by orders dated 20.3.2012 and 28.8.2012 that the refund granted was in excess of the market price of the products exported. Relying on Notification No. 19/2004-CE (NT), dated 6.9.2004 ("Notification 19/2004"), which states that the rebate cannot be in excess of the total market price of the exported goods at the time of export, the rebate amount was thus reduced to Rs. 8,91,295 and Rs. 23,491 based on an independent valuation of the market price on a cost plus basis. Dr. Reddys filed a revision application, which was dismissed.

4. The Revenue demanded the balance amount of the rebate which was questioned by Dr. Reddys, by approaching the Customs, Excise and Service Tax Appellate Tribunal ("CESTAT"). Pending appeal before the CESTAT, the present writ petition impugns the decision of the Revisionary Authority, which forms the basis for the quantified demand raised and which is subject matter of the appeal to the CESTAT. The reasons stated by the Commissioner, exercising powers of review u/s 35E(2) and by the Appellate and finally Revisionary Authorities tread the same path and can usefully be dealt with together. The bone of contention concerns the price used by Dr. Reddys to determine the rebate value.

5. The two review orders dated 20.3.2012 and 28.8.2012 observed that "sanction of the rebate is not legal and proper" due to the incorrect export valuation. This observation was premised on four reasons: first, in terms of the Board''s Circular No. 203/37/96-CX, dated 26.4.96, as the consignment was cleared to a subsidiary unit, i.e. the Jersey subsidiary, the sale price cannot be termed as the ''transaction'' value u/s 4 of the Central Excise Act read with the Monopolies and Restrictive Trading Practices Act, 1969. Instead, it was stated:

"[w]hen the goods are sold to or through a related person or an inter-connected undertaking, the provisions of Rule 9, 10 or 11 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000 [2000 Rules] shall be followed."

It was observed that as the rebate was sanctioned in accordance with Section 11B of the Central Excise Act, and Rule 18 of the Central Excise Rules, 2002, use

of the Customs Valuation (Determination of Value of Export Goods) Rules, 2007 ("2007 Rules") was "a contradiction". It was reasoned that even if the 2007 Rules were applicable, under Rule 3, the sale value can be accepted between related parties only if it had not influenced the transaction. The "huge difference" between the cost of production and the transaction value in this case, and the absence of any findings on this aspect whilst granting the rebate, according to the revenue, rendered the finding questionable. Second, it was noted that:

"[o]n verification of the prices on the Internet, it is observed that though Zyprexa (branded product of Olanzapine 20mg) is available for $15, the Generic product is available for US$ 0.69. Therefore, the export price of US$7 quoted by M/s. Dr. Reddy''s Laboratories Ltd., for its generic product appears to be abnormally high. Thus, prima facie, the DRL resorted to overvaluation of goods and this appears to be with an intention of encash the Cenvat credit by way of rebate."

Similarly, the generic prices for tablets of lower dosage were also found to be lower than that quoted by Dr. Reddys. Third, it was observed that as per the Notification 19/2004 the market value cannot exceed the amount of rebate claimed. Here, it was noted that the branded Olanzapine 20 mg produced by Sun Pharmaceuticals was sold for Rs. 104.50 for 10 tablets in the Indian market. On the basis of this value, the market value of 1,31,01,840 20 mg tablets exported by Dr. Reddys works out to Rs. 13,69,14,228, which was considered by the Commissioner, rather than the value provided by Dr. Reddys. Fourth, on the issue of hidden costs, which were claimed by Dr. Reddys in its cost calculations, it was observed that this matter was covered by Section 233B of the Companies Act, 1956 and the costing of products is to be arrived at based on Standard Accounting Methods, which do not leave any scope for ''hidden'' costs, not in the least without a thorough examination which was missing in this case.

6. In the appeal, the Commissioner (Appeals) held that the

"lower authority should have enquired the market price of the similar/identical goods and decided the eligibility of rebate to the respondents. Since the market price of the similar/identical goods at the time of exportation is found to be less than the amount of rebate of duty claimed, the sanction of the rebate amount is in violation of condition 2 (e) of Notification No. 19/2004-CE(NT) dated 6.9.2004 are liable for rejection."

The order also held that the correct provisions for valuation were not the 2007 Rules, but that Rule 18 of the 2002 Rules read with Rules 9, 10 and 11 of the 2000 Rules. In this case, given that the market value of the product in the Indian market was less than the amount of rebate claimed, Dr. Reddys was not eligible for the rebate "as the FOB/CIF of the product exported and sold in abroad USA has no relevance for sanction of rebate." Equally, the Commissioner (Appeals) agreed with the Revenues argument concerning the inadmissibility of hidden costs under the standard accounting mechanisms that were to be utilized in such

cases. Identical reasons were supplied in both appeal orders concerning 20 mg and 10 mg tablets, dated 20.3.2012 and 28.8.2012.

7. Dr. Reddys then filed revision applications against both orders, which were dismissed by a common order dated 30.10.2012 on the same grounds. Crucially, the correct valuation according to the Commissioner was recorded in these orders. In reaching a valuation, the following issues were noted: the 2000 Rules, and not the 2007 Rules, are applicable, the innovators price (which was much higher) is affected by other considerations and need not be looked into, a manifest increase in the cost price and the sale price implies that there is an influence on the transaction value on account of the link between the related parties. Relying on Rule 11 of the 2000 Rules, it was observed that "the impugned goods are required to be valued as per best judgment using reasonable means consistent with the general principles and provisions under Rule 11 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000." In this manner, the valuation was reached on the basis of cost plus a ten percent markup. This exercise resulted in the cost production value coming to Rs. 16148102, with a 10% markup returning the value Rs. 17762815. Based on this, the rebate claims of Rs. 8,91,295 and Rs. 23,4911 respectively in respect of Olanzapine 20 mg tablets and Olanzapine 10 mg and 5 mg tablets were held admissible as against the rebate earlier allowed of Rs. 21,18,36,117 and Rs. 64,66,0411 by order dated 30.9.2011 and 13.01.2012 respectively and balance amounts of Rs. 21,02,12,794 and Rs. 64,66,041 were directed to be recovered. Dr. Reddys preferred an appeal to the CESTAT, which is currently pending.

8. Learned senior counsel, Mr. Ganesh, appearing for Dr. Reddys argued that the reconsideration of valuation for the purposes of granting the rebate is erroneous. It is argued that Dr. Reddys received an exclusive right to manufacture and sell the Olanzapine drug in the United States (along with the inventor) for a limited period of 180 days. The price in that window period was higher than the price after the expiry of the patent, and thus, those prices are not comparable. It was argued that the Revenue cannot once the rebate has been granted revisit the valuation in such a manner so as to be altered only for the rebate and not the valuation for the purposes of excise duty payment. In this context, it was argued that the export value of approximately Rs. 411 crores was correctly declared and that no authority questioned this figure. In such a circumstance, it is argued, if the export value is not questioned on the basis of which excise duty was paid then no objection can be taken with the rebate claimed.

9. Finally, learned senior counsel relies on the judgment of the Supreme Court in Commissioner of Excise v. Coca Cola India Pvt. Ltd., 2007 (213) ELT 490, for the proposition that no show cause or demand notice needs to be issued at all where the situation is revenue- neutral. In this case, it is argued that the entire purpose of this exercise is to return the excise duty paid on account of export of goods and thus, this litigation and the precedent demand notices are futile.

10. Learned senior standing counsel for the Revenue argued preliminarily that there is an appeal pending before the CESTAT against the demand notice for recovery of the excess excise duty and as such, this writ petition is not maintainable given the availability of an alternative forum. However, the Court notes that the present writ petition challenges the order of revision. The appeal on the other hand does not and cannot challenge the validity of the order of revision. It only challenges the demand that was raised consequent to the decision by the appellate and revisionary authority. The revisional order is premised on the validity of these orders that can only be challenged through the writ jurisdiction of this Court. No other alternative remedy is available to challenge this reversal of the decision to grant rebate and change the valuation of the goods.

11. Learned senior standing counsel next argued that the Revenue retains the authority to appeal through Section 35E(2) an incorrect valuation for the purposes of rebate, which was done in this case. Moreover, reliance is placed on Notification 19/2004 to argue that in this case the amount claimed as rebate (Rs. 21 crores and Rs. 1.75 crores) far exceeded the market value of the goods, calculated either by reference to alternatives available in the Indian market or on the basis of a best value judgment. It is argued in support of the approach of the revisionary authority that since the declared value far exceeded the cost, it was reasonable to conclude that the transaction value between Dr. Reddys and the Jersey subsidiary, two related parties, could not be taken at face value. In such case, other means of valuation that were ignored by the sanctioning authority were rightly taken into consideration and detailed reasons recorded for the findings returned. It was argued therefore, that there is no perversity in the decision of the revisionary authority that merits the interference of this Court.

12. The admitted facts are as follows: Dr. Reddys was granted permission by the United States authorities to manufacture and import to its territory the Olanzapine drug for a window period of 180 days before the expiry of the patent. A copy of this permission is placed on record. For the purposes of working out this permission, Dr. Reddys sold these drugs to its Jersey subsidiary, which was to ultimately sell those drugs. The sale with which this court is concerned is from Dr. Reddys to its foreign subsidiary. Dr. Reddys correctly declared the cost of production and value of the sale transaction to the Revenue authorities. From October 2011 onwards, Dr. Reddys exported the drug in doses of 5, 10 and 20 mgs to its Jersey subsidiary at a price of $7, $3.65 and $2.20 respectively. Dr. Reddys paid excise duty on these products at the applicable rate based on these sale values. The entire payment coming to approximately Rs. 411 crores was realized through normal banking channels, proof of which was admittedly given to the Revenue.

13. Later, Dr. Reddys requested a refund of the excise duty paid under Rule 18 of the 2002 Rules, which is in the following terms:

"Where any goods are exported, the Central Government may, by notification,

grant rebate of duty paid on such excisable goods or duty paid on materials used in the manufacture or processing of such goods and the rebate shall be subject to such conditions or limitations, if any, and fulfillment of such procedure, as may be specified in the notification."

Accordingly, Dr. Reddys applied for and was granted a rebate of the excise duty it paid on the basis of the valuation that was accepted at the time of payment of the excise duty itself. It is at this stage that the entire proceedings concerning revaluation and recovery of ''excess excise'' duty were initiated.

14. It is imperative to note the broader context of these provisions. Rule 18 incentivizes exports, to ensure that export goods are competitive in foreign markets without being burdened with any excise duty. The purpose of Rule 18 is to return the amount of duty that was paid if the goods manufactured in the country are sold outside India. This is recognized in Notification 19/2004, which notes that

"the Central Government hereby directs that there shall be granted rebate of the whole of the duty paid on all excisable goods falling under the First Schedule to the Central Excise Tariff Act, 1985 (5 of 1986), exported to any country other than Nepal and Bhutan, subject to the conditions, limitations and procedures specified hereinafter."

The underlying objective is thus clear: to ensure that any amount paid towards excise duty is recovered. However, to ensure that this provision for rebate is not abused, condition (e) states that "the market price of the excisable goods at the time of exportation" should not be "less than the amount of rebate of duty claimed." Thus, to ensure that an exporter does not receive a net benefit from the rebate of the duty, a ceiling on the rebate is placed in terms of the market price at which the exporter actually sells the goods. In this case, the two Orders-in- Original, dated 30.9.2011 and 13.1.2012, granted the rebate on the following grounds:

"10. On examination of the rebate claim, it is noticed that the assessee have cleared the said goods for export vide ARE-I: No.748/2,011-12 dated 27.6.2011 to their overseas subsidiary company at a value of Rs. 1,13,95,OOO/- per one lakh Nos. of ''Olanzapine-20mg USP'' Tablets as against the cost incurred by them for manufacture of One lakh Nos. ''Olanzapine-20mg USP'' of Rs.1,28,267/-. The reasons put forth by the assessee for such huge margin in price on the export goods, being that they get 180 days, of exclusivity period to market this particular product, for which reason the price is high during this period as DRL will be treated as only other player other than innovator, M/s. Eli Lilly, in the market and that once the exclusivity period is over, the price is likely to come down when other sellers enter the market. I am of the considered opinion that the view expressed by the Range Officer that the provisions of Rule 9 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 shall be applied to arrive at the assessable value of the goods

exported, is not relevant as the Central Excise Act, 1944 extends only to the whole of India in terms of Section 1(2) ibid which is to be considered for valuation also. I am of the view that the provisions of Customs, Valuation (Determination of Value of Export Goods) Rules, 2007 [which came into existence w.e.f. 13.09.2007 vide Notfn. No. 95/2007-CUs(N.T.)] have to be resorted to In respect of Exports. The value shall be "transaction value" within the meaning of sub-section (1) of Section 14 of the Customs Act, 1962. Dr. Reddy''s in their letter dated 23rd Sep, 2011 have Informed that for launching of any new product, the company identifies a product which is having market potential and nearing to expiry from the Innovator and on developing the drug with their technology, file ANDA (Abridged New Drug Application) with USFDA; that on getting approval, from USFDA, the product is bio equivalent to the innovators product and can launch; that the process of getting exclusivity Is through a route of legal litigation with the Innovator and involves huge legal costs.

11. As seen from the above, it is understood that the entire process of launching a new product involves huge expenditure. These hidden costs are also have to be considered for arriving at the sale price of such innovative product. Further, Dr. Reddy''s vide their letter dated 17.08.2011 have undertook to submit the Bank Realisation Certificate on receipt of export proceeds. In view of these facts, the declared value is acceptable.

12. I am satisfied with the documents produced and the exportation of the goods cleared under the said ARE-I. The assessee is therefore, eligible for a rebate- under Rule 18 of the Central Excise Rules, 2002 read with Notification No.19/2004- C E (N T) dated 06.09.2004, as amended. However, .as the duty is calculated and paid on the value declared in ARE.1 for arriving at transaction value the actual freight amount, Insurance, commission and local freight, if any paid are to be

deducted from CIF Value. Therefore, basing on the information furnished, the duty has been re-worked put and arrived at the rebate to be given in cash. The details of ARE.1, the Values, the net F.O.B values, rebate sanctioned in cash and credit allowable as CENVAT Credit are reflected In the table annexed to this order."

15. Independent of the difference between the sanctioning authority in the order-in-original and the appellate authority subsequently on the applicability of the 2007 Rule to cases arising u/s 11B of the Central Excise Act- read with Rule 18 of the 2002 Rules, the appellate/revisionary authority relied on condition (e) of Notification 19/2004 to deny the rebate as earlier granted (as the revisionary order notes: "market price of the similar/identical goods at the time of exportation is found to be less than the amount of rebate of duty claimed"). Indeed, this resolution is necessary to activate condition(e). In this case, Dr. Reddys had stated that no similar goods are marketed in the Indian market, and a comparison of similar goods sold in the United States would show that the

transaction value was not overstated. In support of that stance, the following prices of Eli Lilly (the inventor) and Prasco Labs (its assign) were provided, which have not been disputed by the Revenue.

16. The revisionary authority discarded these prices on the ground that the price charged by the inventor cannot be a basis for comparison and that the substantially lower price charged by Sun Pharmaceuticals in India is a better comparison. It was further held that the substantial mark-up in the transaction between Dr. Reddys and its Jersey subsidiary implied some distortion in the transaction value. Thus, the best judgment method was used with a cost plus 10% mark up as the correct value.

17. This reasoning is unacceptable. Under Rule 18- which contemplates return of the excise duty paid in cases of exported goods,- the market price must necessarily refer to the market where the goods are sold, - in this case, the United States market. The goods in question are neither meant for, nor did they ever enter, the Indian market. If this were not to be the position, the valuation of goods meant for export (in cases of export to countries with a stronger currency valuation; or simply, "developed" countries) would always be incongruous even bizarre. In such cases, the actual value of goods sold abroad would likely exceed the value domestically. Following the Revenues logic, unless the exporter decides to export the goods at the lower domestic price, he or she may never recover the entire excise duty paid on the higher international price. This extinguishes the purpose of Rule 18 of the 2002 Rules, and the policy of ensuring competitive exports.

18. In the present case, approximately Rs. 411 crores was received in India in foreign exchange from the sale of these drugs. On this basis, excise duty was paid and later recovered. At no point did Dr. Reddys receive a net benefit from the transaction. If the Revenues argument is to be accepted, a higher price is accepted by it at the time of payment of excise duty on the basis of the price in the foreign market, but a different (and lower) price is mandated on revaluation for the purposes of refunding that very amount. Far from meeting the purpose of Rule 18, this approach results in a net positive for the Revenue on the basis of differential valuation at different points of the same process. A consistent value based on a distinct principle is to be followed during the entire process. This value the ''market'' price must be the value in the market to which goods are exported. Whilst undoubtedly there may be cases where the valuation ought to be considered more closely if the transaction is between related parties, this case does not present any difficulty. The generic price of $0.69 relied upon by the revisionary authority is the price prevailing in the United States market after the expiry of the 180 day window period. The exports however were made during that window period, when the patent was manufactured by only 3 bodies (Eli Lily, Prasco Labs and Dr. Reddys) and the prevailing price was higher. Condition (e) itself notes that the relevant time is "at the time of exportation", and the comparison of generics who did not exist in the market at the time of export

violates that condition. Similarly, the price that allegedly prevailed in India Rs. 104.50 for 10 tablets is again irrelevant, since that refers to the domestic market. Thus, the market must be correctly chosen, both geographically and temporally. In this case, the United States market during the 180 day window period has prevailing prices between $19.22 (Prasco Labs lowest price) and $33.38 (Eli Lily highest price), which are both clearly above the price of $7 at which the sale was made between Dr. Reddys and its Jersey subsidiary. Moreover, this exercise is typically revenue-neutral. Rule 18 ensures any duty paid is returned, and that excise duty is not added to the cost of exports who are selling abroad. The revenue effect in such cases is to be nil. Thus, it is unfortunate that in the present case it has resulted in two orders of revision u/s 35E(2), the two appellate orders and the common revisionary order, which have led to an appeal before the CESTAT and the present writ petition.

19. The stated purpose of Rule 18 is revenue neutrality, yet, time and resource has been expended on this exercise to neither party''s benefit. The Supreme Court has also at various points recognized that minimum, if any, interference should occur in such cases. (see, Commr. of Income Tax-IV, Delhi and Another Vs. Glaxo Smithkline Asia (P) Ltd., , Commissioner of Income Tax, Chennai Vs. Bilahari Investment (P) Ltd.,).

20. Accordingly, for the above reasons, the order of the Department of Revenue dated 19.12.2013 Order No. 1412/1413-CX, u/s 35EE of the Central Excise Act is hereby set aside, along with any consequential demands raised for recovery of the rebate of excise duty. The Orders-In-Original No. 462/2011-REBATE and No. 03/2012-REBATE, dated 30.9.2011 and 13.1.2012 are accordingly restored. There shall be no order as to costs.

