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BEFORE THE MADURAI BENCH OF MADRAS HIGH COURT

DATED: **28.08.2023**

CORAM

THE HONOURABLE **DR.JUSTICE ANITA SUMANTH**

AND

THE HONOURABLE **MR.JUSTICE R.VIJAYAKUMAR**

C.M.A.(MD)No.1279 of 2015

The Commissioner of Customs,
Customs House, Tuticorin.

...Appellant

-Vs.-

1.The Customs Excise and Service Tax Appellate Tribunal,
South Zonal Bench,
Sasthri Bhavan, Annex, 1st Floor,
No.26, Haddows Road,
Chennai-600 006.

2.K.G.Denim Limited,
Jadayampalayam, Mettupalayam,
Coimbatore-641 302, Tamil Nadu.

...Respondents

PRAYER:- Civil Miscellaneous Appeal is filed under Section 130 of Customs Act, 1962, to set aside the Final Order No.40443 of 2015 dated 16.04.2015 made in Appeal No.C/357/2011-DB on the file of the Customs, Excise and Service Tax Appellate Tribunal, South Zonal Bench, Chennai.



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For Appellant :Mr.AR.L.Sundaresan
Additional Solicitor General
For R2 :Mr.Raghavan Ramabadran
for M/s.Lakshmi Kumaran and
Sridharan Attorneys

JUDGMENT

(Judgment of the Court was delivered by **DR.ANITA SUMANTH, J.**)

This is an appeal filed by the Commissioner of Customs, challenging an order of the Customs, Excise and Service Tax Appellate Tribunal (CESTAT/Tribunal), South Zonal Bench, Chennai dated 16.04.2015.

2.The second respondent herein/assessee had imported raw materials, both dutiable as well as duty free, during the period 2000 to 2002 and utilized them in the manufacturing of denim. One of the raw materials was indigo blue. The first round of exports had been under the Advance Licence Scheme (ALS) during the period from 2002 to 2004, specifically from 14.11.2002 to 25.10.2004.



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3.The ALS contained a pre-condition to the effect that the benefit of the scheme would be availed only if exports were carried out within certain stipulated time frames. There is no dispute on the position that the assessee has achieved the target in that regard and is fully entitled to the benefit of ALS. While this is so, some portion of indigo blue imported by it duty free for the purpose of ALS was found to be in surplus and had been available for the purpose of further manufacture as well.

4.There is admittedly no embargo placed on utilization of the materials imported duty free, post satisfaction of the export obligation under the ALS. Notification No.31/97-Customs dated 01.04.1997 makes it clear that exempted materials, that have been imported, shall not be disposed of or utilized in any manner, except for utilisation in discharge of export obligation, *prior* to discharge of export obligation in full.

5.Thus, evidently, the assessee is free to deploy the raw materials imported *after* discharge of export obligations, in any manner



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as it deems fit, in accordance with law. This position also emanates from clause 4.1.5 of Foreign Trade Policy for the year 2004-09 (FTP 2004-09), to the effect that '*advance licence and/or materials imported shall not be transferable even after completion of export obligation. However, the licensee will have the option to dispose off the product manufactured out of the duty free inputs once the export obligation is completed*'.

6.This is what the assessee has done in the present case. In respect of the period from 05.12.2005 to 09.08.2006, the assessee availed the Duty Drawback Scheme (DD Scheme) and utilized excess indigo blue available with it in the manufacture of products in respect of which it sought the benefit of DD Scheme.

7.The authorities issued a show cause notice calling upon the assessee to show cause why the benefits obtained from the DD Scheme not be reversed seeing as the assessee has availed the benefit of both ALS and DD Scheme in respect of the same raw materials, ie., indigo blue.



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8. That is to say, consignments of indigo blue, that has been imported and utilized in the manufacture of products that had availed the benefit of ALS, had also been used in the manufacture of products, that had received the benefits under DD Scheme. Despite an explanation tendered by the assessee, an order in original came to be passed on 03.03.2011 adverse to its interests.

9. The authority has crystallized the issue for decision as follows:

“(i) Whether the impugned export goods on which duty drawback was claimed and received was manufactured out of duty free input, Vat indigo Blue Dye, imported under ALS.

(ii) Whether the drawback claimed and received by the noticee during the period from 01.04.2005 to 30.09.06 for export made through the ports as mentioned in the notices are eligible or not.

(iii) If not eligible, whether the ineligible drawback is liable to be demanded under Rule 16 of the Customs and Central Excise Duties Drawback Rules 1995 with appropriate interest.

(iv) Whether the goods exported under shipping bills, as mentioned in the notices, for which drawback was claimed and received erroneously, are liable for confiscation under section 113(h)(i) & (ii) of the Customs Act, 1962; and

(v) Whether the KGDL are liable to penalty under Section 114(iii) of the Customs Act 1962.”



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10.The question of confiscation did not arise in this case. On the other issues, the authority decided adverse to the assessee holding that the indigo blue dye imported without payment of duty under ALS ought not to have been utilized for the manufacture of goods exported under the DD Scheme. Hence, the entire drawback claimed, of an amount of Rs.2.23 crores (approx.) was proposed to be reversed with appropriate interest under Section 75A(2) of the Customs Act, 1962 (in short 'the Act'). Penalty was also levied in terms of Section 114(iii) of the Act.

11.As against this order, the assessee approached the Tribunal, which, by way of the impugned order, reversed the order in original. The reversal was done on multiple grounds. Firstly, the Tribunal noticed that insignificant quantity of the indigo blue, which is the subject matter of the litigation, had been used in the second round of manufacture, that is the round of manufacture wherein, benefit under the DD Scheme had been claimed.



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12. Secondly, the Tribunal proceeded on the basis that the fractional quantity of the dye utilized, had been wholly consumed in the process of manufacture and hence, this by itself should not tilt the decision adverse to the assessee. Thirdly, and this is relevant, the Tribunal noted that the rate of duty imposed was the All Industry Rate (AIR).

13. Though they do not discuss the distinction between AIR and brand rate, in conclusion, they state that the declaration of AIR was done, taking into consideration the composition of goods, including both exempted goods as well as dutiable goods and over-all industry behavior in the country. In such circumstances, it was unnecessary, according to the Tribunal, to engage in an exercise of bifurcation of the individual rate components or the individual components of duty qua each input, as what had been applied was a compounded, presumptive rate.

14. It is as against the above order of the Tribunal that the Commissioner has filed the present Appeal raising the following substantial questions of law:



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(1) Whether the Advance Licence and duty drawback are mutually exclusive in view of the Rule 3(1) of the Customs and Central Excise Duties Drawback Rules 1995 r/w General notes No.2(b) to the Notification No. 26/2003 Cus (NT) dated 01.04.2003.

(2) Whether the goods imported duty free under advance licence scheme can be utilized in the manufacture of goods exported under duty draw back (All Industry Rate) and whether the importer cum manufacturer is eligible to avail benefit under both advance licence and duty draw back simultaneously?

15. We have heard Mr. AR. L. Sundaresan, learned Additional Solicitor General for the appellant assisted by Mr. R. Nandakumar, learned Counsel and Mr. Raghavan Ramabadran, learned Counsel for the second respondent.

16. The facts in question are, by and large, admitted. The assessee had admittedly used duty free indigo blue for both imports under ALS as well as exports under the DD Scheme. The exact attribution of duty in respect of the dye is unavailable and we are also of the view that this exercise cannot be engaged in, seeing as what has been applied in this case is the AIR. AIR, by its very title, is a consolidated industry rate, that is fixed by the authorities having regard to various inputs including general trends concerning that industry.



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17.It is the case of the assessee that there is, normally, a vast difference between brand rate and AIR and that AIR is far lower than brand rate. The question of engaging in the exercise of attributing individual rates to the inputs is, thus, impossible in the case of AIR as the rate is crystallized on a presumptive, consolidated basis. Mr.Sundaresan agrees with this position.

18.The Customs and Central Excise Drawback Rules, 1995 (in short '1995 Rules'), deals with 'Drawback' under Rule 3 in the following terms:

3.Drawback.-

*(1)Subject to the provisions of
(a)the Customs Act, 1962 (52 of 1962) and the
rules made thereunder,*

*(b)the Central Excises and Salt Act, 1944 (1 of
1944) and the rules made thereunder, and*

(c)these rules,

*a drawback may be allowed on the export of
goods at such amount, or at such rates, as may be
determined by the Central Government:*

*Provided that where any goods are produced or
manufactured from imported materials or excisable
materials on some of which only, duty chargeable thereon
has been paid and not on the rest, or only a part of the duty
chargeable has been paid; or the duty paid has been
rebated or refunded in whole or in part or given as credit,*



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under any of the provisions of the Customs Act, 1962 (52 of 1962), and the rules made thereunder, or of the Central Excises and Salt Act, 1944 (1 of 1944) and the rules made thereunder, the drawback admissible on the said goods shall be reduced taking into account the lesser duty paid or the rebate, refund or credit obtained:

Provided further that no drawback shall be allowed-

.....
(ii)if the said goods are produced or manufactured, using imported materials or excisable materials in respect of which duties have not been paid; or
.....”

19.Rule 3 of 1995 Rules is absolute to state that, in order to avail the DD Scheme, the manufacture/production of the goods must be by using imported or excisable materials and no drawback shall be allowed, if the raw materials have been imported duty free or exempted from payment of duty. This is an absolute position and had matters remained thus, there would have been no difficulty in answering the substantial questions of law in favour of the appellant.

20.However, there are certain other aspects of the matter that must be taken note of. The FTP 2004-09 at Clause 4.1.14 deals with the admissibility of drawback in the following terms:

4.1.14-Admissibility of Drawback

In the case of an Advance Licence, the drawback



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shall be available in respect of any of the duty paid materials, whether imported or indigenous, used in the goods exported, as per the drawback rate fixed by Ministry of Finance (Directorate of Drawback). The Drawback shall however be restricted to the duty paid materials as mentioned in the licence

21. Thus, the absolute position as set out in the 1995 Rules has been somewhat diluted by the acknowledgement in the FTP of the position that exempted/duty free materials may be deployed in the manufacture of goods claiming benefit of ALS, upon condition that the claim of drawback shall be restricted to the duty paid materials as mentioned in the licence only.

22. To clarify, if there is a combination of both duty free as well as dutiable inputs, then the entitlement to DD Scheme/ALS shall be proportionate to the extent of those items that are dutiable only. This is the first departure from the absolute position in the 1995 Rules. It does not stop there.

23. Circular No.19/2005-Cus dated 21.03.2005 had been issued by the Central Board of Excise and Customs (CBEC/Board) dealing with the '*admissibility of All Industry Rates of duty drawback and exports the*



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goods manufactured from out of inputs, some of which, are non-duty paid'. The Circular is reproduced hereunder:

*Admissibility of All Industry Rates of Duty
Drawback on Export Goods Manufactured from out of
Inputs, some of which are Non-Duty Paid*

CIRCULAR NO.19/2005-Cus

FNo.609/13/2004-DK

Government of India

Ministry of Finance

Department of Revenue

*Sub:Admissibility of All Industry Rates of Duty Drawback
on Export Goods Manufactured from out of inputs, some of
which are Non-Duty Paid.*

I am directed to invite your attention to the above subject and to say that a doubt has been raised as to whether the All Industry Rate of duty drawback is to be denied / reduced on export goods using inputs some of which are non-duty paid. It has been represented that the All Industry Rate of duty drawback is sought to be denied / reduced on floor coverings and made ups on the ground that a part of yarn used has not suffered any duty. Likewise, it has been brought to the notice of the Board that Show Cause Notices are being issued to the garment exporters at the various places and the All Industry Rate of drawback is sought to be denied / reduced on the ground that they have used duty free trimmings & embellishments in the manufacture of export goods. The exporters are being charged with misdeclaration / non-declaration and are being asked to return duty drawback amounts received by them by an amount equal to the duty exemption enjoyed. This, according to trade, amounts to taking away by the left hand what has been given by the right hand.

2. The matter has been examined by the Ministry. In this connection, attention is invited to Board's Circular No. 24/2001-Cus dated 20.4.2001 whereunder it was clarified that All Industry Rates of drawback are based on the



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concept of averages, where the drawback rate itself as well as its customs and excise portions are based on weighted averages of consumption of imported / indigenous inputs of a representative cross-section of exporters and the average incidence of duties suffered on such inputs. These rates have no relation to the actual input consumption pattern or the actual duty incidence suffered on inputs of a particular exporter or individual consignments exported by any exporter under drawback claim. It was categorically stated in the said Circular that the first proviso to rule 3 of Drawback Rules, 1995 is meant for the Ministry and that it essentially provides a guideline as to how the duty drawback rates are to be determined in certain situations and is not intended for the field formations to use this rule for arbitrarily altering All Industry Rates of duty drawback in the case of individual exporters for individual consignments.

3. From the above it may be noted that the concept of All Industry Rate of duty drawback is that the rates are determined taking into account the average duties paid on the inputs and in determining the rates, the average (weighted average) consumption of imported / indigenous inputs of a representative cross-section of exporters is taken into account. In view of this, it is not open to the field officers to question as to how the rate has been determined in the case of individual export goods and to probe whether certain exempted inputs have been used in the manufacture of the same. Accordingly, it is clarified that All Industry Rate of duty drawback is to be allowed in the cases referred to above.

4. Suitable Public Notices for information of the Trade and Standing Orders for guidance of the staff may be issued. Difficulties faced, if any in implementation of the Circular may be brought to the notice of the Board.

Kindly acknowledge receipt of this Circular.

*Yours faithfully,
Sd/-*



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.....
Joint Secretary (Drawback)

21-Mar-05

Telefax:.....

24.Circular No.19/2005 dated 21.03.2005 concedes to the position that duty drawback is sought by manufactures who use exempted/duty free inputs. The rates in such cases are the AIR. To be noted that Clause 4.1.14 of FTP does not specifically talk of either Brand rate or AIR and thus, it is the submission of the assessee that it would apply only to those cases where brand rates apply. This is for the reason that it is only in such cases that a bifurcation of the individual components and consequent apportionment would at all, be possible.

25.A perusal of the Circular makes it clear that AIR duty is to be allowed in full in cases where a portion of inputs would qualify to be non-duty paid. Thus, the absolute position under the 1995 Rules has stands modified somewhat by clause 4.1.14 of FTP and Circular No. 19/2005.

26.Both substantial questions of law are thus answered in favour of the assessee and adverse to the revenue. We hasten to add a



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note of caution. The Circular proceeds on the basis that the inputs that are duty exempt constitute only a fraction of the over-all inputs used, as otherwise, the very purpose of the DD Scheme would become redundant. Abuse of the position, as recognized even under Circular No.19/2005 is not an impossibility.

27.In the present case, there is a finding of fact by the Tribunal to the effect that the indigo blue used in the goods claiming duty drawback, is only a fraction. This finding of fact has not been challenged as perverse in this appeal and has become final. Thus, our answer to the questions of law is premised on this factual finding. This Civil Miscellaneous Appeal is dismissed. No costs.

[A.S.M.J.,] & [R.V.J.,]
28.08.2023

NCC :Yes/No
Index :Yes/No
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R.VIJAYAKUMAR, J.

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