REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.6709 OF 2004

M/S. K.R.C.D. (I) PVT. LTD. …APPELLANT

VERSUS

COMMISSIONER OF CENTRAL EXCISE, MUMBAI ...RESPONDENT

J U D G M E N T

R.F. Nariman, J.

1. The facts of the present case reveal that the appellant started manufacturing duplicate CDs from a master tape/CD issued to them by a distributor who had copyright in the contents of the CD. The following chain will show exactly how the present transaction of job work is done. The artist/lyricist who is the owner of copyright parts with the copyright for a certain consideration to a producer of music which music/picture is then captured on video CD and CD. The producer in turn parts with such copyright in favour of a

distributor who, ultimately, gets the said CDs duplicated as has been stated aforesaid by the appellant on job work basis, and who then sells the CDs in the market to the ultimate customer. The facts also demonstrate that the appellant/assessee is only given the master CD from which it duplicates such master tape/CD on blank CDs that are owned by it and then sold to the distributor copyright holder, having paid a lump sum royalty to the producer of the music which is on the CD. The process adopted by the appellant for duplicating the CDs from the master tape/CD or DAT has been detailed in the impugned order of the Commissioner (Appeals). From the DAT supplied by the customers, the appellants arrange to manufacture a stamper i.e. Nickel plate on which the data is coded. The stamper is used as a mould to manufacture a CD, which while manufacturing the CD, transfers data from the stamper to a CD. The programme which is duplicated on the CD is owned by the customer who is either himself the distributor or is a copyright owner. The distributor/copyright holder then, upon receipt of the duplicate copies from the appellant loads part of the royalty paid to the music producer on each such CD which as has

been stated above is then sold to the ultimate customer in the market. The entire stock of duplicate CDs can only be sold to the distributor/copyright holder and to nobody else.

2. On 31.8.1998, provisional assessments for the period 1995 to 1998 were finalised by the Assistant Commissioner of Central Excise demanding duty *inter alia* on royalty charges incurred by the distributor/copyright holder. The Commissioner (Appeals) by an order dated 20.7.1999 set aside the order dated 31.8.1998 and held that the appellants were already including a royalty of one rupee per CD in the assessable value of the CD and remanded the matter back to the Assistant Commissioner. On remand, the Assistant Commissioner directed the appellant to file a price declaration along with cost break up certified by a chartered account. Such declaration reads as follows:-

> Declaration under Rule 173C dated 14.3.2000 for break up of the cost of CDs.

Raw material and other expenses	6.31
Inlay Card	2.00
Jewel Box	4.30
Royalty (cost of copyright)	1.00

Royalty (Patent charge)	0.43
Total	14.43

Based on the aforesaid declaration, the appellant paid differential duty of Rs.14,31,678/- at the rate of one rupee per CD for CDs cleared during the period 1995 to 2000, and also paid a sum of Rs.10,210/- for CDs cleared for the period 1st March to 14th March, 2000. On 4.12.2001, the Assistant Commissioner issued a show cause notice proposing to demand differential duty of Rs.5,91,45,700/- on CDs cleared during the period November, 2000 to October, 2001. This differential duty consisted of royalty payable to the distributor/copyright holder which royalty was calculated at 54.81 rupees per CD. The basis of the royalty calculation was given in the said show cause notice.

3. On 25.2.2002, the Deputy Commissioner confirmed the show cause notice and also issued a penalty of an equivalent amount plus a penalty of Rs.1 crore on Shri Rajiv Aggarwal, Director of the Appellant Company. By an order dated 2.8.2002, the Commissioner (Appeals) held that the royalty charges incurred by the distributor/copyright holder is liable to

be included in the assessable value of the CDs. He remanded the matter to the Assistant Commissioner to quantify the demand after taking into consideration the amount of royalty to be apportioned, which had been prescribed under a circular dated 19.2.2002. *Vide* an order dated 11th June, 2004, CESTAT confirmed the order of the Commissioner (Appeals).

4. Shri Lakshmikumaran, learned counsel on behalf of the appellant has argued that the job work done by the appellant did not include any element of royalty. In fact, the amount of rupee one that was declared in the price list filed by the appellant was only for the music that is embedded in the CD but not for any royalty thereon. This is clear from the fact that the appellant had to perform certain job work on blank CDs owned by it, which is merely to copy the master tape given by the distributor/copyright holder, and, as is apparent from the price list filed, the distributor/copyright holder is charged for the raw material and other expenses, being the blank duplicate CD, the inlay card, the royalty attributable to the music content of the CD and the jewel box. It is the distributor and others who are the copyright holders who then sell these duplicate CDs in

the market loading on to them the royalty cost paid by the distributor and others in lump sum to the music producer. Since no part of the royalty had in fact passed, no amount of royalty could be included in the assessable value.

5. Shri Rupesh Kumar, learned counsel on behalf of the Revenue argued that when the master tape was handed over by the distributor who was also the copyright holder, obviously what was handed over was a CD with music on it, which music was inextricably bound with royalty that was paid for it. It is clear that the master tape could not be given to the appellant for duplication unless royalty had been paid which royalty would form part of the cost of the goods to be produced by the appellant and then sold to the distributor/copyright holder. In this view of the matter, it would be correct to say that the royalty that is payable would also have to be loaded on to the duplicate CDs produced by the appellant and apportioned in a manner stated in the circular dated 19.2.2002. This being so, there is nothing wrong with the order of the Tribunal that is impugned in the present case.

6. In the present case, Section 4(1)(a) of the Central Excise Act will not apply for the simple reason that price is not the sole consideration for the sale as a master tape had to be handed over by the distributor/copyright holder to the appellant. Since Section 4(1)(b) applies, the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, would apply. Both parties agree that Rule 6 would be applicable to the facts of the present case.

7. Rule 6 of the said Rules reads as follows:

> "Rule 6. Where the excisable goods are sold in the circumstances specified in clause (a) of sub section (1) of section 4 of the Act except the circumstance where the price is not the sole consideration for sale, the value of such goods shall be deemed to be the aggregate of such transaction value and the amount of money value of any additional consideration flowing directly or indirectly from the buyer to the assessee.
>
> Explanation.-For removal of doubts, it is hereby clarified that the value, apportioned as appropriate, of the following goods and services, whether supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale of such goods, to the extent that such value has not been included in the price actually paid or payable, shall be treated to be the amount of money value of additional consideration flowing directly or indirectly from the buyer to the assessee in relation to sale of the goods being valued and aggregated accordingly, namely:-

(i) value of materials, components, parts and similar items relatable to such goods;

(ii) value of tools, dies, moulds, drawings, blue prints, technical maps and charts and similar items used in production of such goods;

(iii) value of material consumed, including packaging materials, in the production of such goods;

(iv) value of engineering, development, art work, design work and plans and sketches undertaken elsewhere than in the factory of production and necessary for the production of such goods."

A reading of Rule 6 shows that the value of the goods referred to in the Rule shall be deemed to be the aggregate of the transaction value and the amount of money value of any additional consideration that may flow directly or indirectly from the buyer to the assessee. Both parties relied upon the explanation to further their case. Since the explanation is determinative of the present case, it is important to note that where the master tape is supplied by the distributor who is the copyright holder to the appellant, whether free of charge or at a reduced cost such master tape must be used in connection with the production and sale of goods by the assessee. What is clear from the present transaction is that the master tape

contains within it music/picture in digital form. There is no doubt whatsoever that the music/picture supplied on the master tape ought to be valued and has been valued as additional consideration that flowed from the buyer to the assessee, and its value has been accepted at rupee one per CD. So far as the royalty payable for such music is concerned, even if we agree with the learned counsel for the Department that such royalty is inextricably connected with the music and therefore would be used in connection with the production of the duplicate CDs, yet the explanation requires that such use must not merely be in connection with production but must also be in connection with the sale of such duplicate CDs. As has been pointed out earlier in this judgment, the entirety of the duplicate CDs is sold only to the distributor who is the copyright holder. Obviously therefore the copyright value in the duplicate CD is not used in connection with the sale of such goods inasmuch as no part of the copyright which may have been passed on by the distributor to the assessee is used by the assessee in selling the duplicate CDs to the distributor who is himself the owner of the copyright. Clearly therefore on the assumption that the music/picture

embedded in the master tape is inextricably bound with the copyright thereof, the copyright is not “used” by the appellant while selling the duplicate CDs to the distributor. The distributor having paid a lump sum royalty to the producer of the music, then sells, after the job work done by the appellant, the duplicate CDs in the market with the cost of the royalty loaded thereon.

8. Clause (iv) of the explanation also makes it clear that the value of art work or design work on goods which is undertaken elsewhere than in the factory of the production and necessary for the production on such goods alone must be taken into account. On the assumption that the music/picture component is the art work in the master CD, that alone is to be taken into account as it is necessary for the production of the duplicate CDs. Royalty payable for such music/picture cannot extend to art work that is necessary for the production of duplicate CDs, as no part of it is in fact taken into account by either the distributor who is the copyright holder or the appellant in the job work done by the appellant.

9. Shri Lakshmikumaran relied upon two judgments of this Court. The first is **Joint Secretary to Government of India v. Food Specialties Ltd.,** 1985 (22) E.L.T. 324 (S.C.). The facts in this case were that the respondent entered into a number of agreements with M/s. Nestle Products (India) Limited and M/s. Nestle Holdings Limited, to manufacture for and on behalf of M/s Nestle Products (India) Limited sweetened condensed milk and other food products for sale in India by Nestle under certain trademarks in respect of which Nestle was registered as the sole registered user in India. The entire production of the respondent was purchased by Nestle and Nestle alone. Since the respondent enjoyed no interest in the trademarks and labels, this Court held that such trademarks and labels cannot form a component of the value of the goods for the purpose of assessment of excisable duty.

10. Similarly, in **Sidhosons & Anr. v. Union of India & Others,** 1986 (26) E.L.T. 881 (S.C.), the appellants were manufacturing electrical goods which were labeled with the brand name “Bajaj” and sold by the appellant only to Bajaj Electricals Limited and to none else. The price fetched by the

goods manufactured by the appellant was the price of the electrical goods without the brand name. It was held:-

> "….The enhancement in the value of the goods by reason of the application of the brand name is because of the augmentation attributable to the value of the goodwill of the brand name which does not belong to the manufacturers and which added market value does not accrue to the petitioner company or go into its coffers. It accrues to the buyers to whom the brand name belongs and to whom the fruits of the goodwill belong. Excise duty is payable in the market value fetched by the goods, in the wholesale market at the factory gate manufactured by the manufacturers. It cannot be assessed on the basis of the market value obtained by the buyers who also add to the value of the manufactured goods the value of their own property in the goodwill of the "brand name". The petitioners are therefore right and the respondents wrong."

11. Both the aforesaid judgments, though decided before the Central Excise Valuation (Determination of Price of Excisable Goods) Rules of 2000, go to show that the value of goodwill contained in a brand name would not form part of the assessable value of goods that are produced and sold only to the owner of the goodwill. In the present case, the appellant also sells the duplicate CDs only to the distributor who is the

owner of the copyright, and this enhancement cannot be added as part of the value of the goods sold in such cases.

12. The Tribunal relied upon a customs case reported in **Associated Cement Companies Ltd. v. Commissioner of Customs,** 2001 (128) E.L.T. 21 (S.C.). In that case, certain drawings and designs were received from abroad as part of technical collaboration and/or knowhow. The value of these drawings and designs was declared at a nominal value of one dollar because according to the appellant the drawings by themselves have no value and it is only the cost of the paper on which they are made that would have any value. On a reading of Rule 9(1)(b)(iv) which is similar to Rule 6 of the Central Excise Rules, this Court held:-

> "39. To put it differently, the legislative intent can easily be gathered by reference to the Customs Valuation Rules and the specific entries in the Customs Tariff Act. The value of an encyclopaedia or a dictionary or a magazine is not only the value of the paper. The value of the paper is in fact negligible as compared to the value or price of an encyclopaedia. Therefore, the intellectual input in such items greatly enhances the value of the paper and ink in the aforesaid examples. This means that the charge of duty is on the final product, whether it be the encyclopaedia or the engineering or architectural drawings or any manual.

40. Similar would be the position in the case of a programme of any kind loaded on a disc or a floppy. For example in the case of music the value of a popular music cassette is several times more than the value of a blank cassette. However, if a pre-recorded music cassette or a popular film or a musical score is imported into India duty will necessarily have to be charged on the value of the final product. In this behalf we may note that in *State Bank of India* v. *Collector of Customs* [(2000) 1 SCC 727 : (2000) 1 Scale 72] the Bank had, under an agreement with the foreign company, imported a computer software and manuals, the total value of which was US $ 4,084,475. The Bank filed an application for refund of customs duty on the ground that the basic cost of software was US $ 401.047. While the rest of the amount of US $ 3,683,428 was payable only as a licence fee for its right to use the software for the Bank countrywide. The claim for the refund of the customs duty paid on the aforesaid amount of US $ 3,683,428 was not accepted by this Court as in its opinion, on a correct interpretation of Section 14 read with the Rules, duty was payable on the transaction value determined therein, and as per Rule 9 in determining the transaction value there has to be added to the price actually paid or payable for the imported goods, royalties and the licence fee for which the buyer is required to pay, directly or indirectly, as a condition of sale of goods to the extent that such royalties and fees are not included in the price actually paid or payable. This clearly goes to show that when technical material is supplied whether in the form of drawings or manuals the same are goods liable to customs duty on the transaction value in respect thereof.

41. It is a misconception to contend that what is being taxed is intellectual input. What is being taxed under the Customs Act read with the Customs Tariff

> Act and the Customs Valuation Rules is not the input alone but goods whose value has been enhanced by the said inputs. The final product at the time of import is either the magazine or the encyclopaedia or the engineering drawings as the case may be. There is no scope for splitting the engineering drawing or the encyclopaedia into intellectual input on the one hand and the paper on which it is scribed on the other. For example, paintings are also to be taxed. Valuable paintings are worth millions. A painting or a portrait may be specially commissioned or an article may be tailor-made. This aspect is irrelevant since what is taxed is the final product as defined and it will be an absurdity to contend that the value for the purposes of duty ought to be the cost of the canvas and the oil paint even though the composite product, i.e., the painting, is worth millions."

13. This case is clearly distinguishable. What was imported by the appellant was not merely paper but drawings and designs on paper whose value had to be added for the reason that the appellants/importers were themselves going to exploit the intellectual content of the goods that were imported themselves. In the facts before us the appellants, as has been pointed out above, do not exploit the intellectual content in the CDs produced by them by way of sale as the sale by them can only be to the copyright owner himself. It is clear therefore that this case would have no bearing on the present case.

14. Given the fact that no part of the royalty can be loaded on to the duplicate CDs produced by the appellant, the circular dated 19.2.2002 which deals with apportionment of royalty would have no application to the facts of the present case. In the circumstances, the impugned judgment dated 11.6.2004 is set aside. Refund, if any, to be made of additional duty collected pursuant to the impugned judgment may be claimed by the appellant in accordance with law. The appeal is allowed in the aforesaid terms.

…….J.
(A.K. Sikri)

…….J.
(R.F. Nariman)

New Delhi;
April 23, 2015.