

"Intended purpose" - What is intended? (By swamy associates)

Notification 43/2001, issued under Rule 19 of the Central Excise Rules, 2002 prescribes the conditions, safeguards and procedures for procurement of excisable goods without payment of duty for the purpose of use in the manufacture or processing of export goods and their exportation out of India. While operating under this Notification, the purchaser (manufacturer - exporter) and the supplier have to follow the procedures prescribed under the Central Excise (Removal of Goods at Concessional Rate of duty for manufacture of excisable goods) Rules, 2001 shall be followed.

This notification is widely used in the textile sector. In this article we intend to address a nagging problem in the working of the above said notification.

Let us take the case of exporters of readymade garments.

They would be purchasing fabrics without payment of duty, under the above said Notification, for being used in the manufacture of the garments. Some of the garments manufactured by them, could not be exported due to quality defects and they have to be sold as seconds in local market. Here a question arises, whether such manufacturers have to pay the duty foregone on the fabric, along with interest, as well as the duty of excise on the garments sold as seconds. If so, the natural next question would be, whether they can take Cenvat credit of the duty being paid by them on the fabric and adjust it against payment of duty on the garments sold in local market?

Let us examine the issue.

As per Rule 6 of the above said rules, if the goods procured thereunder are "not used for the intended purposes", the purchaser (manufacturer - exporter) has to pay the duty payable thereon, but for the exemption, along with the interest. But, it has to be seen, whether in the given circumstances, it can be said that the quantity of fabric contained in the locally sold garments is not used for the "intended purpose". It may be observed that the manufacturer has used the fabric only for the manufacture of garments meant for export, but could not export the same due to quality defects. **It is not a case of diversion of the fabric in local market, instead of using the same for manufacture of export goods.**

Moreover, as per para (v) (c) of the said Notification, clearance of any waste arising during the course of manufacture is also permitted, on payment of appropriate duty on such waste. In such cases, payment of duty on the parent material is not envisaged in the Notification.

Moreover, in Explanation to Rule 6 of the said Rules, the scope of the term "not used for intended purpose" is explained so as to include the cases, where the inputs are lost or destroyed by natural cause, or by unavoidable accident during transportation or during handling and storage. Even here, the stress is only on non use of the inputs before they are put into manufacturing process. This rule does not cover those cases where part of the inputs are contained in any waste or scrap, arising during the course of manufacture.

As such, it is reasonable to conclude that in the stated example, the manufacturers of garments are not liable for payment of duty on the fabric contained in the defective readymade garments sold locally. But, they have to pay duty on the garments sold in local market.

Though the above view may appear to be reasonable - its reasonableness is rendered doubtful, if the following posers-curio are raised.

- a) Should not the government be compensated by way of interest, as no duty is paid on the fabric removed but only paid for the ready made garments manufactured and rendered as seconds, resulting in delay in recovery of the duty on the fabric, to the government?
- b) As the seconds would normally be sold at a lesser price, will it be objected, if the duty payable on such garments is lesser than the duty foregone on the raw materials?
- c) Can the manufacturer - exporter, claim the benefit of exemption contained in Notification 34/2003 and at the same time, plead that he is not liable to pay duty on the fabric, as per the above reasoning? It is pertinent to note that Notification 34/2003 does not contain any condition to the effect that the raw materials should be duty paid. As such, the claim for exemption cannot be legally denied. But it appears to be against equity, in as much as no duty would be paid, either on the raw material or on the final products.
- d) Can a local manufacturer who do not have any export market at all, can also procure the raw materials under notification 43/2001, claiming that he "intend" to export the goods, and thereby postponing duty collection to the government.

As a result of the above, a contrary view could also emerge.

Notification 43/2001 prescribes the procedures and safeguards for procurement of excisable goods without payment of duty "for the purpose of use in the manufacture or processing of export goods **and their exportation** out of India". As such, if the garments manufactured out of such fabrics procured duty free under this Notification are not exported, there is a possibility of an allegation that so much of the fabric is not used for the intended purpose i.e. **ultimate export**.

Accordingly, as per Rule 6 of the Central Excise (Removal of Goods at Concessional Rate of duty for manufacture of excisable goods) Rules, 2001, such manufacturers would be required to pay duty on the fabric, along with applicable interest. The garments sold in the domestic market shall also attract the levy of duty of excise or the benefit of exemption under Notification 34/2003 can be enjoyed for the same, if otherwise eligible.

Now comes the moot question.

If it is argued that duty has to be paid by the manufacturer on such fabrics, can he claim Cenvat credit of the duty thus paid by him and utilise it for payment of duty on the garments sold in the domestic market?

In the event of payment of duty on the garment, the benefit of Cenvat credit for the duty paid by the manufacturer on the fabric shall be extended. But, here the department may argue that, none of the documents envisaged in Rule 7 of the

Cenvat Credit Rules, 2002 is available with the manufacturer, evidencing payment of such duty. This possible objection is not sustainable and can be well fought. The fabrics would have been originally purchased under the cover of an invoice, indicating that the goods are being cleared without payment of duty, under Notification 43/2001. The said invoices and the subsequent TR 6 challan, for the duty paid by the manufacturer in respect of such fabric, would together constitute a valid document for availing credit.

In view of the probability of conflicting views on the subject, as explained above, it would be better if the CBEC comes out with a clarification, before the fabric is torn.