CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
NEW DELHI.

PRINCIPAL BENCH - COURT NO. III

Excise Appeal No. 54686 of 2023-SM

(Arising out of order-in-appeal No. 08 (RLM)CE/JPR/2023 dated 31.01.2023, passed by the Commissioner (Appeals), Customs, Central Excise & Central Goods and Service Tax, Jaipur).

Fabindia Limited **Appellant**
(Erstwhile M/s Fabindia Overseas Pvt. Ltd.,
GT Galleria, Ashok Marg
Near Ahinsha Circle Nalah, Jaipur
Rajasthan -302001

VERSUS

Commissioner, Central Excise & Central Goods and Service Tax, **Respondent**
NCRB, Statue Circle, Jaipur-302 005.

APPEARANCE:

Shri Shashank Goel, Advocate with Sh. Varun Sahni, C.A. for the appellant
Sh. Mahesh Bhardwaj, Authorised Representative for the respondent

CORAM:

HON'BLE MS. BINU TAMTA, MEMBER (JUDICIAL)

FINAL ORDER NO. 51549/2023

DATE OF HEARING: 28.08.2023
DATE OF DECISION: 14.11.2023

BINU TAMTA:

The present appeal is directed against the order-in-appeal No. 08 (RLM)CE/JPR/2023 dated 31.01.2023, whereby the Commissioner (Appeals) confirmed the Order-in-original dated 30.09.2021.

2. The brief facts of the case are, the appellant is engaged in manufacturing of readymade garments and made-up articles of textile falling under Chapters 62 and 63 and was paying Excise Duty @ 2% under the Notification No. 9/2016-CE dated 01.03.2016 without

availing the cenvat credit. The records of the assessee was subjected to audit and it was found that some footwear items falling under Chapter 64 from various vendors were sold after affixing their brand name "Fab India" without payment of duty. The appellant was therefore liable to pay excise duty of Rs. 6,08,901/-. Further, during the course of the audit it was also observed that the appellant had received an amount of Rs. 47,20,817/- in view of penalties from their vendors during the period October, 2014 to June, 2017 and as per the provisions of Section 66E of the Finance Act, 1994 were liable to pay service tax amounting to Rs. 7,04,381/-. Accordingly, show cause notice dated 15.05.2020 was issued towards demand of Rs. 6,08,901/- towards excise duty under Section 11A of the Central Excise Act, 1944 and Service Tax amounting to Rs. 7,04,381/- with consequential interest and penalty under the respective provisions.

3. The Adjudicating Authority relying on the definition of 'manufacture' under Section 2(f)(iii) of Central Excise Act and in terms of the various clauses of the agreement executed by the appellant with their vendors concluded that the activity of affixing "Fab India" label, MRP tags, barcode on the footwear amounts to 'deemed manufacture' as the label, tags and barcodes are the property of the appellant and were to be affixed as per their specifications and hence is liable to pay the excise duty. On the issue of service tax liability also, the Adjudicating Authority referring to the provisions of Section 65B(44) read with Section 65E(e) of the Finance Act, 1994 observed that the amount of penalty collected or recovered from the vendors for not completing the contract within the

prescribed period of time was nothing but a consideration of an activity of tolerating a situation arisen by breach of terms/ conditions by the contractors and therefore the service tax liability was made out against the appellant. The appeal filed by the appellant challenging the Order-in-original dated 30.09.2021 was allowed by the Commissioner (Appeals) by the impugned order. Hence the present appeal has been filed before this Tribunal.

4. I have heard the learned Counsel for the appellant as well as the Authorised Representative for the Revenue and have perused the case law submitted during the course of hearing.

5. The main issues considered by the authorities below are as under:-

(i) Whether the activity conducted by the assessee was chargeable to Central Excise duty?

(ii) Whether the penalties recovered by the assessee from the vendors were chargeable to service tax?

6. On the first issue whether the activity in the present case casts liability of excise duty on the appellant, the learned Counsel has submitted that the appellant company is basically engaged in the business of trading of garments, furniture, organic food and personal care products and was registered under the Central Excise Act. The submission of the appellant is that all the activities incidental to manufacture, like packing or repacking, labelling or relabeling including the declaration of the retail sale price on the product are

done by the vendors of the company and relied on clauses 7, 8, 13 and 14 of the agreement which reads as under:-

> **"Clause 8**: Labels have to be affixed correctly as per specifications. All labels must be sourced from Fabindia approved manufacturer only. All labels are the property of Fabindia and misuse will be penalised by termination of contract.
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> **Clause 9**: Tags and barcodes must be affixed correctly as per the specifications laid down by PSC. All tags and barcodes are the property of Fabindia and any misuse will be penalised by termination of contract.
>
> **Clause 14**: Correct bar codes must be affixed on the productions as per specifications. Fabindia reserves the right to impose a penalty in case wrong price tags are affixed to production that result in a loss to the company.
>
> **Clause 15**: Packing instructions must be followed. The packaging of the product should ensure that the item reaches the store in perfect saleable condition. Please review the packing details with the category/ Quality teams of Fabindia".

7. The learned Counsel for the appellant has referred to several decisions, Diamond Cements Ltd., vs. Commissioner of Central Excise, Bhopal -2012 (283) ELT 226 (Tri. Del.), Mayo India Ltd., vs. Commissioner of C. Ex. Aurangabad -1999 (113) ELT 1036 (Tri.) and Burman Laboratories Ltd., vs. Commissioner of Central Excise, Indore -2000 (122) ELT 52 (Tri.).

The law on the issue is well settled that excise duty is on the manufacture of goods and the liability to pay is on the manufacturer. In terms of the definition of 'manufacture' as provided in section 2 (f) of the Act, a person who undertakes any of the activities specified therein is a manufacturer and as interpreted, a job worker engaged in any of the said activities is liable to pay duty on the goods manufactured by him unless exempted.

Consequently, by virtue of the Notification No 214/86 dated 15.3.1986, the liability of the job worker to pay excise duty is passed on to the principal manufacturer subject to the condition that the principal manufacturer gives a declaration/ undertaking to pay the duty.

8. Considering the various clauses of the agreement in the light of the various decisions I am of the view that the authorities below have erred in observing that in terms of the definition of manufacture under section 2 (f)(iii) of Central Excise Act, the appellant appears to be involved in 'deemed manufacture' and thereby liable to pay excise duty. The authorities below have not examined the issue as settled by the Apex Court and also by the Tribunal which are binding on them and have therefore arrived at an erroneous decision. In the present case, the appellant is engaged only in the activity of trading and the entire activity of manufacturing the products is done by the vendors. Maybe that the raw material, labels, tags and barcodes are provided by the appellant and the activity is carried out as per their specifications, however that does not make the appellant the manufacturer rather it is the vendor who is the actual manufacturer. I would like to refer to the decision of the Larger Bench of this Tribunal in **Mayo India Ltd Vs. Commissioner of C. Ex, Aurangabad 1999 (113) ELT 1036**, where the appellant entered into agreement for manufacture of medicine as per their specifications, requirement and bearing their trademark and brand name for which they supplied the raw material. The relevant para of

the decision settles the law which is squarely applicable to the present case:-

> "6. We have considered the submissions of both sides. The undisputed facts are that the appellants were getting the medicines manufactured from others out of the raw material supplied by them as per their specifications and under their brand name under agreement. The terms and conditions of the agreement reveal that the transactions between the appellants and the manufacturer of the medicines was on a principal to principal basis. The department has not adduced any evidence to show that the appellants were exercising control and supervision over the manufacturing activities in the premises of the manufacturers. There is no allegation contained also in the show cause notice that the appellant and the manufacturers of the product were related persons. The Apex Court in the case of Ujagar Prints v. UoI - 1988 (33) ELT 535 (SC) has held that excise duty is on the manufacture of goods and is levied, upon the manufacturer in respect of the commodity taxed. The question whether the producer is or is not the owner of the goods is not determinative of the liability. The Supreme Court held that processors of fabrics become liable to pay excise duty because they cause the manufacture of the goods. This was the view of the Supreme Court in the case of Kerala State Electriity Board and in the case of CCE v. M.M. Khambhatwala -1996 (84) ELT 161 (SC). The Appellate Tribunal in the case of CCE, Bombay-II v. Hab Pharmaceuticals -1996 (87) ELT 704 held that according to Section 2(f) of the Central Excise Act, a brand name holder or supplier of raw material does not become manufacturer; that the brand name holders and the actual manufacturers are independent units. Similar views were held by the Tribunal in the case of Card Cure Engineering Co. Vs. CCE, Coimbatore -1996 (86) ELT 351. The Tribunal in the case of CCE v. C.R. Auluck & Sons (P) Ltd., held that brand name owner cannot be treated as such under Section 2(f) of the Act. It is now well settled law that job worker using his own machinery and labour force and not supplier of raw material is to be considered manufacturer of goods. In view of these facts and the decisions of the Supreme Court and the Tribunal, it cannot be said that the appellants are the manufacturer of goods merely because they had supplied the raw material and the goods were manufactured as per their specifications. Accordingly, the impugned order is set aside and appeal is allowed on merit without going into the question of time limit."

9. Further, in **Burman Laboratories Limited 2000 (122) ELT 52**, the Tribunal held that the conditions in the agreement that the manufacturer shall manufacture the goods strictly in accordance with the specifications and or the standard laid down by the buyer or that the manufacturer will permit the buyer to visit their premises, sample of branded goods shall be supplied and the manufacturer shall not independently manufacture and sell the branded goods to strangers, would not make the brand name owner the manufacturer of the goods. The Tribunal observed that these are normal commercial terms and they do not constitute mutuality of interest

between the parties and the terms of the agreement are no ground for assessing the goods as manufactured by the appellant and accordingly there is no basis for holding the appellant to be the manufacturer of the goods in question. Applying the principles as aforesaid, I am of the opinion that the appellant cannot be held to be the manufacturer of the footwear and hence no excise duty is leviable on them.

10. The learned Counsel for the appellant has alternatively relied on the Notification No. 214/86-CE dated 25.3.1986 to say that incidental activity of manufacture carried out by vendors on behalf of the appellant was as job workers then the liability has to be on the job worker and the appellant cannot be made liable to pay the duty. I feel that no reliance can be placed on the notification since the raw material supplied by the appellant was not under the provisions of the notification. Moreover, the specific plea taken in the appeal is that the vendors of the appellant are not job workers which is evident from the fact as stated that the appellant does not provide any raw material or labels to these vendors.

11. On the second issue of non-payment of Service Tax on fine and penalty received by the appellant from their vendors in lieu of deficiency in supply of goods on account of quality or late delivery, the learned Counsel submitted that it was not on account of any independent activity but is in the form of mechanism for settlement of price of goods. Since the vendor is not rendering any services to the appellant, the receipt of penalty towards supply of goods does not

amount to "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act". The appellant is not liable to pay the service tax thereon. The provisions of Section 65B(44) of the Finance Act provides that "service" means any activity carried out by another for consideration, and includes the declared service. The term "declared service" has been defined under Section 65B(22) of the Finance Act as any activity carried out by a person or another person for consideration and declared as such under Section 66E.

Section 66E of the Finance Act, 1994 sets out the declared services and the same reads as under:-

> "The following shall constitute declared services, namely:-
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> (e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;"

12. Learned Counsel for the appellant relied on various decisions of the Tribunal, particularly in the case of **Steel Authority of India Ltd., Salem vs. Commissioner of GST & Central Excise, Salem -2021 (7) TMI 1092- CESTAT Chennai** and also in **South Eastern Coalfields Ltd., vs. Commissioner of Central Excise and Service Tax, Raipur -2020 (12) TMI 912 –CESTAT, New Delhi**.

13. I find that the decision in **South Eastern Coalfields Ltd.,** (supra) relied on the earlier decision of the Larger Bench of the Tribunal in **Bhayana Builders Pvt. Ltd., vs. CST -2013 (32) STR 49**, which has been affirmed by the Supreme Court reported as **2018 (2) TMI 1325** in the following words:-

"By using the words "for such service provided" the Act has provided for a nexus between the amount charged and the service provided. Therefore, any amount charged which has no nexus with the taxable service and is not a consideration for the service provided does not become part of the value which is taxable under Section 67."

14. It is necessary to reproduce the relevant para of the decision of the Tribunal in **South Eastern Coalfields Ltd.,** (supra):-

"27. It is trite that an agreement has to be read as a whole so as to gather the intention of the parties. The intention of the appellant and the parties was for supply of coal; for supply of goods; and for availing various types of services. The consideration contemplated under the agreements was for such supply of coal, materials or for availing various types of services. The intention of the parties certainly was not for flouting the terms of the agreement so that the penal clauses get attracted. The penal clauses are in the nature of providing a safeguard to the commercial interest of the appellant and it cannot, by any stretch of imagination, be said that recovering any sum by invoking the penalty clauses is the reason behind the execution of the contract for an agreed consideration. It is not the intention of the appellant to impose any penalty upon the other party nor is it the intention of the other party to get penalized.

28. It also needs to be noted that Section 65B(44) defines "service" to mean any activity carried out by a person for another for consideration. Explanation (a) to Section 67 provides that "consideration" includes any amount that is payable for the taxable services provided or to be provided. The recovery of liquidated damages/penalty from other party cannot be said to be towards any service *per se,* since neither the appellant is carrying on any activity to receive compensation nor can there be any intention of the other party to breach or violate the contract and suffer a loss. The purpose of imposing compensation or penalty is to ensure that the defaulting act is not undertaken or repeated and the same cannot be said to be towards toleration of the defaulting party. The expectation of the appellant is that the other party complies with the terms of the contract and a penalty is imposed only if there is non-compliance."

15. A perusal of the contents of the agreement executed by the appellant with their vendors does not show that the agreement is for providing any services for which any consideration has to be paid

and as noticed in **South Eastern Coalfields Ltd.,** (supra) the contract may provide for penalty provisions for breach of the terms of the contract but that would not make the same consideration for a contract as has been noted, that there is a mark distinction between 'condition of a contract' and 'consideration for a contract'. The decision in **South Eastern Coalfields Ltd.,** (supra) has been subsequently followed by this Tribunal in the case of **Steel Authority of India Ltd.,** (supra) reiterating the principles to conclude that it is not possible to sustain the view taken by the Commissioner that since the task was not completed within the time frame, the appellant agreed to tolerate the same for a consideration in the form of liquidated damages, which could be subjected to service tax under Section 66E(e) of the Finance Act.

16. The present case is squarely covered by the aforesaid decisions of the Tribunal and in that view no liability of Service Tax under Section 66E(e) can be fastened on the appellant.

17. The learned Counsel for the appellant has referred to Circular No. 178/10/2022-GST dated 3.08.2022 whereby it has been clarified that any penalty or compensation received for any loss or damage caused by breach or non performance of the terms of the contract is not by way of consideration for any independent activity rather the same is in the course of performance of the contract, hence not taxable under the GST regime including the erstwhile serves tax regime. The relevant para of the circular is quoted herein below:-

> "7.1.5. Examples of such cases are damages resulting from damage to property, negligence, piracy, unauthorised use of trade name, copyright, etc., m Other examples that may be covered here are the penalty sti9pulated in a contract for delayed construction of houses. It is a penalty paid by the builder to the buyers to compensate them for the loss that they suffer due to such delayed construction and not for getting anything in return from the buyers. Similarly, forfeiture of earnest money by a seller in case of breach of 'an agreement to sell' an immovable property by the buyer or by Government or local authority in the event of a successful bidder failing to act after winning the bid, for allotment of natural resources, is a mere flow of money, as the buyer or the successful bidder does not get anything in return for such forfeiture of earnest money. Forfeiture of Earnest money is stipulated in such cases not as a consideration for tolerating the breach of contract but as a compensation for the losses suffered and as a penalty for discouraging the non-serious buyers or bidders. Such payments being merely flow of money are not a consideration for any supply and are not taxable. The key in such cases is to consider whether the impugned payments constitute consideration for another independent contract envisaging tolerating an act or situation or refraining from doing any act or situation or simply doing an act. If the answer is yes, then it constitutes a 'supply' within the meaning of the Act, otherwise it is not a "supply".

The controversy for levy of service tax on the penalty amount received by the appellant gets resolved in favour of the appellant also by virtue of the said Circular.

18. I, therefore, set aside the demand towards excise duty and also the service tax on the appellant and consequently demand of interest and penalty and in that view the issue of limitation does not survive. I, therefore, set aside the impugned order and allow the appeal. The appeal is, accordingly, allowed.

(Pronounced on 14th November, 2023).

(Binu Tamta)
Member (Judicial)

Pant