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Undervaluation due to adoption of lower mutually agreed price

MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)

PUBLIC ACCOUNTS COMMITTEE 2007-2008

FIFTY-SEVENTH REPORT

FOURTEENTH LOK SABHA

LOK SABHA SECRETARIAT
NEW DELHI

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'UNDERVALUATION DUE TO ADOPTION OF LOWER MUTUALLY AGREED PRICE'

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LOK SABHA SECRETARIAT
NEW DELHI

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INTRODUCTION

I, the Chairman, Public Accounts Committee, as authorised by the Committee, do present this Fifty-Seventh Report relating to "Undervaluation due to adoption of lower mutually agreed price" which is based on Paragraph No. 11.3 of Report of Comptroller and Auditor General of India for the year ended 31 March, 2005 (No. 7 of 2006), Union Government (Indirect Taxes—Customs, Central Excise & Service Tax).

2. The Report of the Comptroller and Auditor General of India for the year ended 31 March, 2005 (No. 7 of 2006), Union Government (Indirect Taxes—Customs, Central Excise & Service Tax) was laid on the Table of the House on 19th May, 2006.

3. The Committee took evidence of the representatives of the Ministry of Finance (Department of Revenue) on the subject at their sitting held on 17th October, 2006. The Committee considered and finalised this Report at their sitting held on 2nd November, 2007. Minutes of the sittings form Annexures to the Report.

4. The Committee would like to express their thanks to the officers of the Ministry of Finance (Department of Revenue) for the cooperation extended by them in furnishing information and tendering evidence before the Committee.

5. The Committee place on record their appreciation of the assistance rendered to them in the matter by the Office of the Comptroller and Auditor General of India.

6. The Committee also place on record their appreciation for the invaluable assistance rendered to them by the officials of Lok Sabha Secretariat attached with the Committee.

NEW DELHI;
7 *November*, 2007
16 *Kartika*, 1929 (*Saka*)

PROF. VIJAY KUMAR MALHOTRA,
Chairman,
Public Accounts Committee.

REPORT

PART I

BACKGROUND ANALYSIS

I. Introductory

Section 4(3)(d) of Central Excise Act, 1944, defines 'transaction value' as the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount the buyer is liable to pay to or on behalf of the assessee, by reason of, or in connection with the sale payable at the time of sale or any other time. Transaction value, therefore, is the price actually paid for the goods sold when price is the sole consideration in a sale. The Ministry of Finance *vide* their circular dated 30 June 2000 clarified that but for the normal value being replaced by transaction value, there was no difference in the scheme of valuation of petroleum products under the old section 4 and new section 4 and that the provisions of the section 4 when applied to the administered price of petroleum products should not make any material difference in assessable value.

II. Audit Paragraph

2. This Report is based on Paragraph No. 11.3 of the Report of C&AG of India No. 7 of 2006 (Indirect Taxes—Customs, Central Excise & Service Tax) relating to 'Undervaluation due to adoption of lower mutually agreed price' examination of relevant material on record and the deposition made by the representatives of the Ministry of Finance, Department of Revenue and Central Board of Excise & Customs. The points arising out of the Audit paras and matters connected thereto are dealt with in the succeeding paragraphs.

3. According to the Audit para, five terminals of M/s. Indian Oil Corporation Ltd. (IOCL) at Bhatinda, Jalandhar, Jaipur, Jodhpur and Sangrur engaged in storage and marketing of various petroleum products received in their bonded warehouse, stock of Motor Spirit (MS), High Speed Diesel (HSD) and Superior Kerosene Oil (SKO) etc. from their refineries. The IOCL terminals apart from clearing the products to their own distribution outlets also cleared MS, HSD and SKO etc. to terminals/depots belonging to other oil companies like M/s. Bharat Petroleum Corporation Ltd. (BPCL) and M/s. Hindustan Petroleum Corporation Ltd. (HPCL) on payment of duty on assessable value which was much less than that charged from their own outlets/terminals.

4. Audit observed that though the administered price mechanism was dismantled from April 2002, prices of petroleum products continued to be monitored and regulated by Oil Coordination Committee (OCC). Basic price structure of the products which formed the basis for determination of retail outlet prices charged from the ultimate consumer remained uniform for all the oil companies. As such adoption of lower assessable value at the stage of clearance of the products by IOCL installations to

other oil companies resulted in lower duty realisation. Clearance of products at lower (agreed) rates resulted in inflow of extra consideration to the other oil companies from ultimate consumers because the benefit of lower excise duty was not passed on to the ultimate consumer retail sale price having remained the same. Accordingly, the price charged did not remain the sole consideration for sale and, hence, could not be considered as ' transaction value' for the purpose of levy of duty. The differential duty lost on the clearances of MS and HSD made to M/s. BPCL and M/s. HPCL terminals and their depots during April 2003 to September 2004 amounted to Rs. 27.76 crore.

5. The Department in their reply to Audit observation stated that two terminals (Bhatinda and Sangrur) intimated that Show Cause Notices (SCNs) for Rs. 5.90 crore covering clearance upto 31 March 2004 had been issued and in respect of Jalandhar and Jodhpur SCNs were being issued. However no reply was furnished in respect of Jaipur.

6. The Ministry of Finance (Department of Revenue), while contending the Audit observation putforth their view that the transaction had taken place in accordance with an agreement entered into between IOCL and other oil marketing companies and the price charged was the sole consideration for sale. It further stated that the transactions satisfied the conditions laid down in section 4 leaving no ground for invoking the provisions of Valuation Rules.

7. Audit pointed out that reply of the Ministry is not tenable as the price mutually agreed upon by the oil companies cannot be considered as 'transaction value' in terms of section 4(i)(a) as products so cleared were actually sold by other petroleum companies at the same price at which their own products were sold. The clearance by IOCL to other oil companies at lower assessable value was thus not based upon purely commercial considerations and the assessable value was to be determined in terms of the Valuation Rules.

III. Submissions of the Ministry of Finance

8. Explaining their point of view on Audit paras, in a written submission made to the Committee, the Ministry of Finance (Department of Revenue) stated as under:—

> "With effect from 1.4.2002, the Government of India deregulated the petroleum sector and the Administered Price Mechanism (APM) was dismantled, and Oil Coordination Committee (OCC), which was the coordinating agency for production, pricing and distribution of petroleum products, was dissolved. With this, petroleum companies became free to price their products. Due to sensitive nature of petroleum products and in view of the infrastructural, operational and logistic constraints and to ensure regular supply of the petroleum products, the four major Oil Public Sector Undertakings (PSUs), *viz.*, M/s Indian Oil Corporation Ltd. (IOCL), M/s Hindustan Petroleum Corporation Ltd. (HPCL), M/s Bharat Petroleum Corporation Ltd. (BPCL) and M/s. Indo Burma Petroleum Ltd. (IBPL), entered into Memoranda of Understanding (MoU), whereby any of these Oil Marketing Companies (OMCs) having a warehouse/refinery at any location was obliged to exchange the products with other Oil companies as per logistic plan at mutually agreed price. The Sale Price of products sold to the OMCs was

based on the Import Parity Prices (IPP) and it reflected the price that would be incurred if these products were imported by the OMC.

For valuation of goods for levy of duty of Central Excise, the concept of transaction value was introduced in the Central Excise Act, 1944, w.e.f. 1.7.2000. In view of the concept of transaction value, the petroleum companies started paying duty on the basis of prices so determined under the aforesaid MoU. This resulted in a situation adverse to Revenue, wherein the assessable value for clearances to such companies' own dealers was different from that of clearances to other OMCs even though the retail price to the ultimate consumer was same in the two cases".

9. Contending the Audit's observation, the Ministry have putforth their argument as under:—

"Objection is not tenable because it has nowhere been shown that the transaction value adopted by the assessee is a coloured one. It was further explained that the transaction value has to be determined as per law. In the case taken up by Audit, study of the agreement would clearly show that the transaction value is not some "mutually agreed price" but it is the "price determined on strict commercial basis" and Audit has not shown any evidence by which it may be concluded that the price was not the genuine price".

10. The Ministry have further added:—

"The transactions of petroleum products between IOCL and other oil companies involve 'sale' and there is no evidence that this price has been influenced by any extra-commercial consideration. The said transactions have been made on the contracted price based on certain formula as per import parity price and there is nothing on record to conclude that the said transactions of sale of petroleum products are not on principal to principal basis and not at arm's length".

11. However, supporting the view of Audit were the observations made by Commissioner of Central Excise & Customs, Vishakhapatnam Commissionerate while adjudicating the Show Cause Notice issued in this regard. According to the order passed by the Commissioner of Central Excise & Customs, Visakhapatnam-1 Commissionerate it was held that:—

"Prior to 01.04.2002, the pricing of petroleum product was as per the Administered Price Mechanism (APM) and the prices were fixed by the Oil Co-ordination Committee (OCC). For the purpose of levy of excise duty, the ex-storage sale price was considered by OCC. The asessable value remained same irrespective of product sold through depot of a particular oil company which had the product in its bonded warehouse or the products cleared to the depots of the other petroleum companies. However, w.e.f. 01.04.2002, the APM has been dismantled and all the four companies, entered into the aforesaid agreement for product sharing whereby any oil company having a warehouse/refinery at any given location is obliged to exchange the products with other oil companies as per the logistic plan proposed by these companies under the leadership of M/s IOCL.

M/s HPCL are clearing goods to their own depots/dealers as well as to IOCL, BPCL and IBP as per the agreement for Oil Exchange. These oil companies sell all these petroleum products through their depots/dealers network at the same price as sold by M/s HPCL to its dealers/depots. On examination of the Oil Exchange agreement the prices adopted to the depots/dealers appeared to be more appropriate price to arrive at the transaction values for the Oil Exchange clearances. There is difference between the prices charged to their own depots/ dealers and to the other Oil Companies. The price difference is indirectly recovered/received from other oil companies against the goods lifted by them at other places from other Oil Companies. All the oil companies are benefited by doing Oil Exchange.

HPCL(VT) are adopting two different values for the purpose of paying Central Excise Duty as under:

(a) For their own customers, the assessees are paying duty by backward calculation from the retail sale price and then arriving at the assessable value/transaction value for paying Central Excise duty.

(b) For transfer of petroleum products to Other Oil Companies under OIL Sharing agreement, the assessees are paying Central Excise duty on the basis of Import Parity Price (IPP). This price is lower than the price at (a) above.

In view of the detailed provisions set out in the agreement and the Annexures attached to the agreement, it appeared that the price at which the goods are removed to the other oil companies under the Oil Exchange basis is not on sale in terms of the provisions contained in section 4(1)(a) of the Central Excise Act. The price agreed as discussed in the agreement is a national price for product sharing with a view to ensure smooth supply and distribution of the petroleum products. As admitted in the agreement itself, the parties to the agreement have entered the agreement for mutual benefit for using the available product of each other on terms and conditions contained in the agreement. Further, the parties agreed to sell and purchase the products to each other for the quantities determined for month to month based on the principles laid down in the Industry Logistic Plan (ILP) procedures. The Import Parity Price based on which the duty is discharged for Oil Exchange supplies is defined to mean the landed cost price of the product at particular port. It is, thus, a mutually settled price among the Oil companies for settling the quantities exchanged under the agreement. It appears that the sale of these goods actually occurs at the end of depots/dealers of the receiving oil companies where they discharge sales tax as well. The monetary transaction amongst them for exchange of petroleum products is only for the excess/short drawls taking into account their All India Level Oil Exchanges on a monthly basis through debit notes. The price at which, the duty has been paid for such supplies under the Oil Exchange, therefore, is not representative of the transaction value defined in section 4(1)(a) and 4(3)(d) of the Central Excise Act".

12. The Commissioner of Central Excise further stated in his order that:—

"The petroleum products exchanged under the OIL Sharing MOU are actually sold by the other petroleum companies through their depots/dealers at the same price at which these petroleum products are sold at the depots by the assesee. Therefore, the transaction value adopted for payment of duty on goods removed under Oil Exchange appears to be a facade for sale with a view to evade proper payment of duty. It further appears that by signing MOU in the manner as indicated above, all the oil marketing companies have mutually benefited themselves. The petroleum products shared with other oil companies are not sold at the time of clearance from the warehouse of HPCL strictly in terms of Section 4(1)(a). Therefore, it can be considered that for the clearance of petroleum products under oil exchange agreement there is no transaction value available in terms of clause (a) Section 4(1) of the Central Excise Act. It also appears that the assessee gets compensated by receipt of the bartered product from the depots/ outlets of the receiving oil companies at other places and the same are sold by M/s HPCL at the prevailing price applicable to the place.

As seen from the price pattern, the price charged by M/s HPCL (VT), Malkapuram, Visakhapatnam to the other oil companies is much lower than what is charged to their own dealers. As per the agreement, the assessee is getting the product at the same price (IPP) for similar quantity elsewhere in the country from other oil companies and the same is being sold at higher price. From these transactions only Oil Companies are benefited throughout the country at the cost of Government Exchequer.

As per section 4(1) of the Central Excise Act, where, the duty of excise is chargeable on the goods with reference to value, then on each removal of the goods, such value shall:—

(a) in a case where the goods are sold by the assessee for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value;

(b) in any other case, including the case where the goods are not sold, be the value determined in such manner as may be prescribed.

"The Transaction value is defined in Section 4(3)(d) to mean the price actually paid or payable for the goods, when sold and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organisation expenses, storage, outward handling, servicing, warranty, commission or any other matter, but does not include the amount of duty of excise, sales tax, and other taxes, if any actually paid or actually payable.

It is, thus, seen that the transaction value as defined in section 4(1)(a) provides that the value would be the price actually paid for the goods sold when the price

is the sole consideration. In this case, the price adopted for payment of duty for goods removed under Oil Exchange is not the price actually paid or payable for the goods when sold. It is a notionally determined price in mutual interest for sharing/assistance from each other among the Oil Marketing Companies in order to ensure smooth supply and distribution of the products and to avoid any kind of disruption of supply all over India. The Import Parity Price for MS and HSD as determined in terms of the agreement is not the price for sale of goods. It is the notional price for exchange of goods and the monthly settlements among the Oil Companies is done based on Joint Certificates, based on which, monthly billings for all the elements of price, duty, freight, taxes and other charges is exchanged and final settlement thereof as made consequently. Therefore, in view of the detailed provisions made in the agreement including the procedures/provisions in the various Annexures to the agreement, it appears that the price on which the duty has been paid for removals under oil exchange does not represent the transaction value defined in sections 4(1)(a) and 4(3)(d).

The value of excisable goods cleared under Oil Exchange transactions, therefore, is to be determined in accordance with the provisions of section 4(1)(b) of the Central Excise Act read with relevant provisions of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.

However, in their case, the transaction price to the dealer under Section 4(1)(a) is ascertainable and is available as they sell the same products in the market at a particular price.Therefore, in accordance with the provisions contained in Rules 7 and 11 of the Central Excise (Valuation) Rules, 2000, the price at which the assessee sells the goods to its dealers shall be adopted as the transaction value/ price at which the assessee is required to pay the duty on the clearances made under Oil Exchange to the other oil companies.

The transactions under the agreement cannot be considered as fully commercial relationship as all the parties to the agreement stood to gain mutually by this arrangement as they have adopted lower price for the purpose of payment of duty. It is, in a way, the basic acquisition price of the goods for mutual benefit. The goods acquired under the agreement are sold to their dealers for retail sales in the commercial sense. The clauses in the agreement show that the price is not the sole consideration for sale. The consideration of exchange of the same products in the same manner linked to the import parity price is evident. The import parity price is the price at which they acquired the imported product. The price under the Oil Exchange agreement is, therefore, only for exchange parity and does not represent the correct and true sale price. The overhead expenses, the selling expenses, the profit margins etc. are not included in this price arrived on Import Parity Price. If the price represented the transaction value as defined in Section 4, the same would represent the normal elements associated with the manufacture and sale of the products and thus, would include the overheads associated with sale. Under the Oil Exchange agreement, the quantities alone are exchanged on the basis of the import parity price and the monthly settlement statements are prepared for settlement of the bills under the agreement. The

price under the Oil Exchange agreement, therefore, does not represent the true intrinsic value of the goods removed. In the case of sale of the same products to their dealers at the same place, the price is higher and representative of the transaction value. It is also relevant to note that the goods acquired under the Oil Exchange agreement are sold to the dealers without any distinction. Thus the stream of goods manufactured/obtained otherwise than under the Oil Exchange in their own refinery and those acquired under the Oil Exchange agreement are sold in the same manner to the dealers for retail sales. This factor, should itself make it clear that the parties to the agreement have been consciously adopting a lower price with intent to pay lower excise duties.

The Price would be representative if there was no mutual consideration of sale and purchase on sharing basis. The price would be acceptable if it included all the normal elements of costs and expenses associated with the sale price of the goods. The sale/purchase under the agreement is only akin to a situation in the "barter system" where reciprocal exchange of the commodities took place. Thus, there was a special relationship among the oil companies. They had adopted a lower price linked to the Import Parity Price, which is not the correct price for the purpose of assessment of excise duty. The price adopted for sale/purchase under the agreement was a notional price, as the goods were not sold at this price to the trade and their dealers. As per the provisions in the agreement, the price is not the sole consideration for the sale of the goods. The sale price is influenced by the consideration of getting the same product for the similar quantity throughout the country at the same basic price. The parties to the agreement are oil companies and are Public undertakings and engaged in the refining or marketing the oil products and with the common objective set out in the agreement, they have agreed to purchase the products of each other; of the quantities determined from month to month, based on the principles laid down in the Industry Logistics Plan set out in the agreement.

The price for the purpose of payment of duty has to meet the parameters set out in Section 4. While the parties are free to enter into any agreement on sharing basis for the smooth distribution of the petroleum products yet when normal price within the meaning of Clause (a) of sub-section (1) of Section 4 of Central Excise Act, 1944 is not available under the Oil Exchange agreement, the provisions of Clause (b) of Section 4(1) read with the Valuation Rules, have to be resorted to determine the price of the goods for the purpose of payment of duty and it will be justified to reject the price under the Oil Exchange agreement for the purpose of payment of duty. When a fully commercial price is available at the factory gate or the depots of the duty paid stocks for sales to their dealers or retail outlets, the same price should form the basis for assessment of the quantities sold under the Exchange agreement. Therefore, in such a situation, action has to be resorted under the provisions of Rule 11 of the Valuation Rules, 2000. This rule has to be read with principles enunciated in Rules 1 to 10. The principles of Rule 4 could be applied since the values as mentioned in Rule 4 *i.e.* value of goods sold by the assessee for delivery at any time which applies to valuation of goods sold to an

independent buyer, is available in this case. In case of the price available at the depots, the principles in Rule 7 could be applied.

Therefore, the price available to the dealers at the factory gate or the depot is adopted for the purpose of payment of duty in respect of products sold under the Oil Exchange agreement in terms of Rule 11 of the Central Excise Valuation Rules, 2000".

13. While confirming the differential duty which was proposed in the Show Cause Notice, the Commissioner enunciated that:—

"It must be seen that the assessee has adopted the price, which they knew, was lower as compared to the transaction value adopted for the dealers. The goods sold to the dealers comprised of the stocks acquired under the Oil Exchange agreement and those manufactured in their own refineries. They were self-assessing the goods for the purpose of payment of duty by adopting two different values for the same goods. They knew that sale and purchase of the petroleum products under the Oil Exchange agreement is on a sharing basis in mutual interest in order to ensure smooth supply and distribution for the mutual benefit. They knew that such a price under the agreement, was not the true or correct transaction price as defined in Section 4. Therefore, they had willfully and deliberately misdeclared the price for the purpose of payment of duty by suppressing the agreement and evaded payment of duty in violation of the provisions of Section 4 and Rules 4 and 6 of the Central Excise Rules. Accordingly, they are liable for penal action under Section 11AC of the Central Excise Rules. Accordingly, they are liable for penal action under Section 11AC of the Central Excise Act. Their contention that they were public sector undertakings and had no motive to evade duty is not tenable. The provisions of Section 11A do not create any such immunity. The parties to the show cause notice have been conscious that the price being adopted for payment of duty did not represent the true price and yet they adopted the price for payment of duty. The Import Parity Price was relevant to them for exchange. If it was not true or correct commercial price to the trade, the same, in no way, could be taken as the transaction price for payment of duty. The differential duty, therefore, was liable to be recovered under the proviso to Section 11A(1) of the Central Excise Act, 1944."

14. With regard to the steps taken by the Ministry it has been stated that the Central Board of Excise and Customs in the Ministry of Finance constituted a Task Force for examination of issues arising with regard to valuation of petroleum products consequent to dismantling of APM. The Task Force was constituted on 31.12.2003 and was headed by Director General of Inspection, Customs and Central Excise, New Delhi.

IV. Findings of Task Force

15. Enumerating the findings of Task Force, the Ministry stated as under:—

* The Oil companies were paying Central Sales Tax (CST) on sale to each other and transaction as defined in Article 4 of the MoU falls within the

definition of "Sale and Purchase" as defined in Section 2(h) Central Excise Act. From data, it was proved that the transactions were not in the nature of barter.

* It was held by field formations that the Government of India holds majority shares in the PSU oil companies, they need to be considered as inter-connected undertakings. Task force observed that the fact that two units are inter-connected undertakings is not in itself sufficient for rejecting the transaction value. It can be done only if it is established that they are 'related persons' [Section 4(3)(b)] Rule 10 of Valuation Rules refers that we could treat the parties as related only if they are so associated that they have interest, directly or indirectly, in the business of each other. Apex Court has held that the interest has to be financial interest.

* DGCEI stated that there is nothing in the reports of the Chief Commissioners to suggest that price is not the sole consideration or that there is a flow-back from one Oil PSU to another in the course of marketing of goods to each other under the aforesaid Agreement. Thus, related person reasoning was not found sustainable.

* It was observed that price applicable to sale of products to other OMCs is bound to be lower for the simple reason that the marketing costs (terminalling expenses) and the margins of buying OMC have to be part of ex-storage price.

* It was observed that "Transaction value concept" recognizes the assessment of goods on the basis of each transaction. There can be different assessable values for the same product, provided that the goods are sold on commercial consideration and transaction is made on principal to principal basis, *i.e.* at arm's length.

* Task force observed that reduced incidence of excise duty on inter-OMC transactions has emerged as a natural consequence of application of transaction value assessment system.

* Task force felt denying the application of Section 4(1) (a) are far too weak, if not completely extraneous and far-fetched.

* Having arrived at the above said conclusion, Task force opined that there was a case for equalizing the incidence of duty on both types of transactions, in order to mop up the differential duty between the two assessable values.

* First option suggested was to introduce separate provision in the Central Excise law for valuation of petroleum products, taking it out of the ambit of Transaction Value concept.

* Second suggestion was to fix moving tariff values on the basis of dealer price.

16. With regard to action taken on findings of the Task Force, the Ministry stated as under:—

> "The recommendations made by the Task Force for introducing separate provision in the Central Excise law for valuation of petroleum products, taking it out of the ambit of Transaction Value concept or to fix moving tariff values on the basis of dealer price have, however, not been found acceptable by the Ministry".

V. Subsequent Developments

17. While furnishing the subsequent developments that had taken place in the matter, the Ministry stated as under:—

> "Firstly the warehousing facility, as per which OMCs were paying the duty from depots has been withdrawn and the refineries are now paying duty at the time of clearance from the refinery point. Secondly, in the Finance Bill 2005, the duty structure with regard to MS and HSD was changed to a combination of specific and *ad valorem* rates of duties in lieu of earlier *ad valorem* rates of duties".

18. Deposing before the Committee about the system of valuation of petroleum products, the Revenue Secretary stated as under:—

> "Prior to 1.7.2000, the date on which Section 4 of the Central Excise Act was amended, excise duty on petroleum products was paid on price ex-storage point irrespective of the fact whether the sales were made directly to dealers or to oil companies. The CBEC, in its Circular No. 223/57/96-CX, dated 21.6.1996 had laid down detailed instructions on determination of assessable value of petroleum products. The oil companies were paying tax in accordance with this Circular. However, Section 4 of the Central Excise Act was amended with effect from 1.7.2000, changing the method of arriving at the value for the purpose of payment of excise duty. It was through this amendment that the concept of assessable value based on normal price was changed to transaction value. However, the oil companies continued to pay excise duty on APM products in accordance with the practice that prevailed prior to 1.7.2000 until 31.3.2002.
>
> When the Government of India deregulated the petroleum sector on 1.4.2002, the situation changed. With effect from 1.4.2002, prices of motor spirit and high speed diesel were to be market determined and prices of superior kerosene oil (PDS) and LPG (domestic) were to be regulated in accordance with the subsidy regime.
>
> Since the prices of kerosene oil (PDS) and LPG (domestic) continued to be under the control of Government, oil companies are paying excise duty at ex-storage point selling price. For other products, including motor spirit and high speed diesel, excise duty is paid on the basis of transaction value.
>
> With the change in the Central Excise Act coupled with the change in the regulation of the petroleum sector, Government decided that there should be economies in the way in which the oil companies operate. The Ministry of Petroleum and Natural Gas, therefore, issued a letter dated 10.7.2001, wherein it was decided

that the PSUs will immediately conclude MoUs intended to reduce cost and streamline functioning. These MoUs were to cover not only product sharing amongst public sector oil companies but also sharing of infrastructure facilities and hospitality arrangements. I may reiterate once again that the objective of Government was to bring about efficiency and economy in operation. It was on the basis of this direction of the Ministry of Petroleum and Natural Gas that the MoUs were concluded between the oil comapnies".

19. While dealing with the issue of transaction value, the Secretary Revenue quoted the provisions of section 4 of the Central Excise Act which lays down the following principles of transaction value:—

'Where under this Act, the duty of excise is chargeable on any excisable goods with reference to their value, then, on each removal of the goods, such value shall:

(a) In a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value;

(b) In any other case, including the case where the goods are not sold, be the value determined in such manner as may be prescribed'.

The explanation to this Section further elaborates the point. It reads,

'For the removal of doubts, it is hereby declared that the price-cum-duty of the excisable goods shall be the price actually paid to him for the goods sold and the money value of the additional consideration, if any, flowing directly or indirectly from the buyer to the assessee in connection with the sale of such goods, the such price-cum-duty, excluding sales tax and other taxes, if any, actually paid shall be deemed to include the duty payable on such goods'.

20. Explaining about the applicability of transaction value for assessment purposes, the Secretary putforth before the Committee as under:—

"For applicability of transaction value in a given case for assessment purposes, the following requirements should be satisfied:

(i) The duty shall be on each removal of goods. In other words, there can be variation in value for duty purposes even from consignment to consignment;

(ii) The goods are sold by the assessee for delivery at the time and place of removal;

(iii) The assessee and the buyer are not related;

(iv) Price should be the sole consideration for sale; and

(v) The price relevant for payment of excise duty shall be the price actually paid to the assessee, including any other consideration flowing directly or indirectly from the buyer to the assessee."

21. Dwelling on the subject further, the Revenue Secretary stated as below:—

"The question, therefore, is whether the choice of import parity price for determining sale by one oil company to another is in any way a deviation from the principle of transaction value. It may be noted in this connection that the principle of import parity price was also reached on the basis of a Resolution of the Ministry of Petroleum and Natural Gas dated 21.11.1997. The Resolution, which led to the implementation of the de-regulated pricing scheme, reads, *inter alia*,

'The system of retention pricing is abolished for all (existing and new) refineries, and pricing of petroleum products at refinery gate level will move towards import parity'.

I may mention that with effect from June 2006, the concept of import parity price has given way to the concept of trade parity price. Following the recommendations of the Rangarajan Committee price for company-to-company sale is now based on trade parity price which is the weighted average of 20 per cent of export parity price and 80 per cent of import parity price."

22. Explaining the case that was decided by CESTAT as to whether the price fixed constituted transaction value, the Secretary further stated as:—

"Initially, the Department also had similar doubts-as was expressed by the Audit and the Commissioner of Central Excise, Vizag-I, in the case of M/s HPCL. While adjudicating a Show Cause Notice, the Commissioner held that since the aforesaid agreement was for mutual interest between refinery and oil marketing companies, price at which goods were cleared to other marketing companies was not true transaction value, and it was, accordingly, decided that the price at which the products were sold to the dealers would be the basis for arriving at the Excise Duty. It was also held that the transaction under the argeement cannot be treated as based on commercial consideration, since all the parties stood to gain mutually by the arrangement. Accordingly, the demands of differential duty raised on the assessee were confirmed. The Commissioner's findings were, however, challenged by M/s HPCL before the Customs, Excise and Service Tax Tribunal, and the Tribunal, after considering the rival submissions, held that, with effect from 1.7.2000, the value to be adopted for levy of excise duty is the transaction value, and that the value at which the transaction is effected can be raised only if there is a flow back from the buyer to the seller, which is not reflected in the transaction value declared to the department. Moreover, the Tribunal noted, the price of the products supplied to the Oil Marketing Companies is based on Import Parity Prices, and there is nothing in law stipulating that different prices to different buyers are not permissible. The Tribunal further noted that the agreement among the oil companies has been entered into on a directive from the Government of India, and this results in an optimal utilisation of the marketing facilities of the various companies in the country and also, in reducing the cost of transportation. The Tribunal also went through the agreement and did not find any ground to hold that the transactions are not at arm's length, further observing that even if

the agreement between the companies results in mutual benefit, the Revenue should not feel unhappy so long as duty is paid on the transaction value. With the above observations and conclusions, the Tribunal allowed the appeal filed by the assessee".

23. The Ministry while submitting to the Committee about the latest position of the case, stated as under:—

"Revenue, however, filed an appeal against the Tribunal's ruling, before the Hon'ble Supreme Court, but the Apex Court also dismissed the Civil Appeal filed by the Revenue upholding the position taken by the CESTAT".

24. While elaborating the concept of 'transaction value', the Revenue Secretary apprised the Committee about its merits and advantages as under:—

"(i) The concept of transaction value is in accordance with best international practice for assessment of goods. The primary basis for customs valuation under the WTO Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, 1994, is transaction value as defined in Article 1 of the said Agreement. Most countries have adopted the concept of transaction value in customs and many in respect of excise or VAT. VAT is on transaction-to-transaction basis.

(ii) Transaction value is a concept that is clear and transparent both to the assessing authority and the taxpayer. It takes into account the market reality where different prices can be charged by a seller to different buyers. It cuts out all elements of arbitrariness in the fixation of assessable value and eliminates the need for repeated and protracted litigation on normal price. It applies across the board to all commodities and has sufficient safeguards built in to ensure that the pricing is at arm's length and that there is no flow back to the assessee.

(iii) It cannot be said that the principle of import parity price invariably and uniformly works in favour of the oil companies. There is greater fixity and stability in using import parity refinery gate price. While import parity refinery gate price is revised every fortnight, the selling price for consumers remains more stable.Thus, during the period April, 2002 to June, 2006, refinery gate price was revised more than 100 times to reflect the increases in the price of crude, but the selling price to consumers remained more stable and changed only 30 times. There have been several cases where the import parity price was higher than the depot sales price. The net effect of the use of transaction value is therefore not certain and may go in favour of revenue or against it depending on the change in import price of crude.

(iv) It may be noted that the differential prices charged in the past are now no longer a matter of such serious concern. In the past, duties were levied on an *ad valorem* basis mostly and hence the duty was highly price sensitive. Following the recommendations of the Lahiri Committee in 2005 and keeping in view the interests of consumers, the Government has now switched over to a system in which the greatest component of duty on petroleum products

is the specific duty. For instance, in respect of petrol, the rate of duty as on 28.2.2005 was 23 per cent of assessable value plus Rs. 7.50 per litre. As on 1.3.2005, the duty rate became 8 per cent *ad valorem* plus Rs. 13 per litre. Thus, the duty today is related more to volume than to price.

(v) It may be noted that the warehousing facility which permitted oil companies to transfer excisable products from refineries to marketing depots and installations without payment of duty at the refinery gate has been withdrawn from September, 2004. As a consequence, the Department gets its revenue earlier than under the previous system resulting in further gain to the department and higher cost to the oil companies."

25. The views that have been submitted contesting the Audit observations are summarised as follows:—

"(i) There exists no extra consideration nor there is any flow-back beyond the agreed upon price. Therefore, the price at which inter-company transactions have taken place is the transaction value for the purpose of section 4 of the Central Excise Act, 1944. The product sharing agreement to sell products at a different price, does not establish mutuality of interest among the oil companies. In these cases, the buyer and the sellers are not a Holding Company or a Subsidiary Company of each other and cannot be treated as related persons.

(ii) The concept of transaction value applies separately for each transaction for assessment and there is no concept of a "Normal Price" (as used to be the case in law prior to adoption of transaction value based assessments under Central Excise Law). Each transaction being independent in nature, will have transaction value shown in the respective invoice which will be the basis of determination of assessable value and has to be accepted as such in the absence of any evidence of extra consideration—direct or indirect, which is not the case here.

(iii) The Customs, Excise and Service Tax Appellate Tribunal (CESTAT) *vide* Final Order no. 306-307 dated 28.2.2005 in HPCL *vs.* C.C.E. Vizag {2005 (187) ELT 479 (Tri. Bang)} had rejected the Government's plea that as agreement was for mutual interest between refinery and oil companies, price at which goods were cleared to other marketing companies was not true transaction value. Civil appeal filed by the Government against the said ruling of CESTAT has been dismissed by the Hon'ble Supreme Court of India *vide* orders dated 3.1.200".

26. Hon'ble Supreme Court of India, while dismissing the Civil Appeal filed by the Government against the said ruling of CESTAT, *inter alia* held as under:—

"Transaction value can be assailed, if there is a flow back from the buyer to the seller, which is not reflected in the transaction value declared to the department. In this case Revenue has not established that the other Oil Companies are siphoning some extra amount to the appellant, which is not reflected in the value

on which duty has been paid. Moreover, the price of the products supplied to OMCs is based on the Import Parity Price. There is nothing in law stipulating that different prices to different buyers are not permissible. In other words transaction value can be challenged if conditions stipulated in section 4(1) (a) are not fulfilled. In this case, the sale is complete at the time and place of removal, where the products are filled by the appellants in the tank/truck/wagon as nominated by the other oil companies for onward dispatch to their dealers. It should be appreciated that the agreement among the oil companies has been entered into on a directive from the Government of India. This results in an optimal utilization of the marketing facilities of the various companies in the country and reducing the cost of transportation. It is better for a refinery to market its products at a nearby marketing facility owned by another company than to send the same goods to its own marketing facility at a far off place. Alternatively, when the company having a refinery has a marketing outlet at some other place, nearer to a refinery of a different company, then it would be better for that marketing outlet to purchase the product from that refinery rather than receive from their own refinery. This arrangement definitely, reduces the transportation cost and is only in public interest. On going through the agreement we do not find any ground to hold that the transactions are not at arm's length. It should also be borne in mind that the days of the concept of normal price are over when the concept of transaction value was introduced in the year 2000. In fact it would be worthwhile to quote from Board's Circular dated 30.06.2000.

The definition of 'transaction value' needs to be carefully taken note of as there is fundamental departure from the erstwhile system of valuation that was essentially based on the concept of 'Normal Wholesale Price', even though sales were effected at varying prices to different buyers or class of buyers from factory gate or Depots etc.

The new Section 4 essentially seeks to accept different transaction values, which may be charged by the assessee to different customers, for assessment purposes so long as these are based upon purely commercial consideration, where buyer and the seller have no relationship and price is the sole consideration for sale. Thus, it enables valuation of goods for excise purposes on value charged as per commercial practices rather than looking for a notionally determined value".

PART II

OBSERVATIONS AND RECOMMENDATIONS

27. The concept of 'transaction value' to determine valuation of goods for computation of central excise duty was brought into effect from 1 July 2000 replacing the earlier concept of 'normal value', that is determination of assessable value on a normative basis. Section 4(3)(d) of Central Excise Act, 1944, defines 'transaction value' as the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount the buyer is liable to pay to or on behalf of the assessee, by reason of, or in connection with the sale payable at the time of sale or any other time. Transaction value, therefore, is the price actually paid for the goods sold when price is the sole consideration.

[Sl.No. 1]

28. Audit scrutiny has revealed that five terminals of M/s Indian Oil Corporation Ltd. (IOCL) cleared/sold certain petroleum products to other oil companies on payment of duty on assessable value which was much less than that charged from their own outlets/terminals. Two key issues finding have emerged out of the audit findings— (a) the clearance of products at lower (mutually agreed) rates to other oil companies not only resulting in revenue loss but also in the inflow of extra consideration to these companies from ultimate consumers who were not given the benefit of lower excise dutyand, (b) the price charged, not being the sole consideration for sale, could not be treated as 'transaction value' for the purpose of levy of duty.

[Sl. No. 2]

29. Even after dismantling of Administered Price Mechanism (APM) in April 2002, prices of petroleum products continued to be monitored and regulated by Oil Coordination Committee. Thus the basic price structure of the products which formed the basis for determination of retail outlet prices charged from the ultimate consumer remained uniform for all oil companies. Therefore, adoption of lower assessable value at the stage of clearance of the products byIOCL installations to other oil marketing companies resulted in lower duty realization without commensurate benefit to the consumers. However, the Committee find that the transactions that had taken place were in accordance with the agreement entered into between IOCL and other oil marketing companies. The genesis of the agreements amongst oil marketing companies was the change in the Central Excise Act coupled with the change in the regulation of the petroleum sector and the decision of the Government to have economies in the way in which the oil companies operated. The Memoranda of Understanding (MOUs) amongst the oil companies were intended to reduce costs and to streamline their functioning. These MOUs included not only product sharing but also sharing of infrastructure facilities and hospitality arrangements. The Committee have been given to understand that it was on the basis of a direction of the Ministry of Petroleum and Natural Gas that the MOUs were concluded between the oil companies.

[Sl. No. 3]

30. From the foregoing, two conflicting view points emerge on the issue. The first view, which is reflected in the audit paragraph and endorsed by the Commissioner of Central Excise, Vishakhapatnam, holds that the price of petroleum products removed/sold to other oil companies under mutual agreement cannot be considered as 'sale' in term of the provisions of the Central Excise Act. This view considers such a mutually agreed price as only a notional price for product sharing with a view to ensuring smooth supply and distribution of petroleum products. As per the agreement itself, the parties to the agreement namely, the oil companies have entered into such an agreement for mutual benefit for using products of each other on terms and conditions contained in the agreement. It was thus concluded that the price at which the excise duty has been paid for such supplies under the Oil Exchange Agreement resulted in extra consideration to the Oil Marketing Companies (OMCs) and is thus not representative of transaction value as defined in the Central Excise Act. The Petroleum Product Exchange under the aforesaid Oil Sharing MOU enabled selling by the other Oil Companies through their Depots/Dealers at the same price at which these petroleum products were sold at the Depots by the assessee himself. Therefore, the view emerged that the transaction value adopted for payment of duty on goods removed under Oil Exchange appeared to be a mere facade for sale with a view to evade proper payment of excise duty. It further gave rise to an apprehension that by signing a MOU, the OMCs have only sought to mutually benefit themselves. It has been contended that if one considers the transaction value as defined in Central Excise Act as the value at which the prices were actually paid for the goods, when price is the sole consideration, the price adopted for payment of duty for goods removed and sold in the instant case under Oil Exchange cannot be deemed as the price actually paid or payable for the goods sold. Citing this argument, the Commissioner of Central Excise, adjudicating the case, arrived at the conclusion that considering the provisions of the mutual agreement entered between the oil companies, the price on which the Central Excise Duty has been paid for clearances of goods under Oil Exchange does not represent the "transaction value" as defined in the provisions of the Central Excise Act. Instead, he was of the view that the price at which the assessee sold the goods to their dealers shall be adopted as the transaction value/price at which the assessee was required to pay the duty.

[Sl. No. 4]

31. The alternate view on this issue, as adjudicated by the Customs, Excise and Service Tax Appellate Tribunal (CESTAT) and upheld by the Hon'ble Supreme Court and now endorsed by the Ministry of Finance (Department of Revenue) in their submissions to the Committee, affirms that the mutually agreed price between the oil companies does not violate the provisions of the Central Excise law. This viewpoint propounds that the amended provisions [Section (4)] of the Central Excise Act essentially seeks to accept different transaction values, which may be charged by the assessee to different customers, for assessment purpose so long as these are based upon purely commercial consideration where the buyer and the seller have no

relationship and price remains the sole consideration for sale. This enables valuation of goods for excise purposes on value charged as per commercial practice rather than looking for a notional value. It has further been stated in support of this view that the agreement among the Oil Marketing Companies (OMCs) has been entered into on a directive from the Ministry of Petroleum and Natural Gas in order to facilitate optimal utilization of the market facilities of the various oil companies across the country and for reducing the cost of transportation. It was felt that it would be better for a refinery to market its product at a nearby marketing facility owned by another company than to send the same to it own marketing facility at a far-off place. The Tribunal, which considered this case, was thus of the view that there was no ground to hold that the mutually agreed price among the oil companies was not transaction value under the law. It was concluded that such a mutual agreement among the OMCs was only to ensure smooth distribution of the petroleum products and the formula arrived at by them for fixing the selling price of the petroleum products was the genuine selling price.

[Sl. No. 5]

32. In the meantime, the Committee note that the Ministry of Finance have taken some steps to resolve the issue by stipulating payment of duty by Oil Companies from the refinery point and by changing the duty structure with regard to HS and HDS to a combination of specific and *ad valorem* rates of duty *in lieu* of earlier *ad valorem* rates of duties. Further, the price for the sale from one Oil Company to another is currently based on trade parity price (weighted average of 20% export parity price and 80% of import parity price). However, the Committee find that the Ministry have not accepted the recommendations of the Departmental Task Force with regard to equalizing the incidence of duty on inter-OMC transactions by introducing a separate provision in the Central Excise law for valuation of petroleum products, taking it out of the ambit of Transaction Value concept and also to fix moving tariff values on the basis of dealer price. As the Task Force was specially constituted to resolve the ticklish issue of valuation of petroleum products, the Committee would like the Ministry to re-examine the whole issue in all its ramifications and arrive at a judicious decision in the matter so that the interest of Revenue stands well-protected at the same time facilitating smooth transportation and distribution of petroleum products across the country. Based on this re-examination if necessary, suitable amendments may be carried out in the valuation provisions of central excise law and the tariff structure so as to remove the existing ambiguities in the provisions and plug the possible misuse. If required, an Inter-ministerial Group comprising of representatives from the Ministry of Finance (Department of Revenue) and Ministry of Petroleum and Natural Gas and other concerned agencies may be constituted for this purpose so that the problem of under-valuation and suppression of price in respect of petroleum products is harmoniously resolved once and for all.

In the light of findings in the subsequent Audit Reports *viz.* for the years 2006 and 2007 regarding under-valuation of excisable goods, the Committee would also like the Ministry to enquire into instances of under-valuation of excisable goods and initiate corrective measures including incorporation of appropriate riders in the present provisions. The Committee would await the Ministry's response in this regard.

[Sl. No. 6]

NEW DELHI;
7 *November*, 2007
16 *Kartika*, 1929 (*Saka*)

PROF. VIJAY KUMAR MALHOTRA,
Chairman,
Public Accounts Committee.

ANNEXURE I

MINUTES OF THE TWELFTH SITTING OF THE PUBLIC ACCOUNTS COMMITTEE (2006-2007) HELD ON 17TH OCTOBER, 2006

The Committee sat from 1100 hrs. to 1300 hrs. on 17th October, 2006 in Committee Room "D", Parliament House Annexe, New Delhi.

PRESENT

Dr. K. Malaisamy — *Chairman* (in the absence of Prof. V.K. Malhotra)

MEMBERS

Lok Sabha

2. Shri Khagen Das
3. Shri Brajesh Pathak
4. Shri Madan Lal Sharma
5. Shri Rajiv Ranjan 'Lalan' Singh
6. Shri Kharabela Swain
7. Shri Tarit Baran Topdar

Rajya Sabha

8. Shri Janardhana Poojary
9. Shri Suresh Bhardwaj
10. Shri Prasanta Chatterjee

SECRETARIAT

1. Shri S.K. Sharma — *Additional Secretary*
2. Shri Ashok Sarin — *Director*
3. Shri R.K. Suryanarayanan — *Assistant Director*

Officers of the office of the C&AG of India

1. Ms. Mohua Chatterjee — ADAI
2. Shri Jayanti Prasad — Pr. Director

Representatives of Ministry of Finance (Department of Revenue)

1. Shri K.M. Chandrasekhar — Secretary (Revenue)
2. Shri P.C. Jha — Member
3. Shri Devender Dutt — Member

CBEC's Field Formation

1.	Shri Jogendra Singh	—	Director General, Vigilance
2.	Shri B.K. Gupta	—	Director General (Inspection), Customs & Central Excise

Representatives of Ministry of Petroleum and Natural Gas

Shri Prabh Dass	—	Joint Secretary (Petroleum)

2. In the absence of the Chairman due to his unavoidable pre-occupation, Dr. K. Malaisamy was requested by the Members present to chair the sitting. Dr. K. Malaisamy agreed to their suggestion and chaired the sitting.

3. At the outset, the acting Chairman, welcomed the Members and the Officers of C&AG to the sitting of the Committee. He informed the Members that the sitting had been convened to take oral evidence of the representatives of the Ministry of Finance (Department of Revenue) and Central Board of Excise and Customs (CBEC) regarding "Delay in finalisation of demands" and "Undervaluation due to adoption of lower mutually agreed price". Thereafter, the Officers of the Office of C&AG briefed the Committee on the specific points arising out of Paragraph Nos. 4.5.2, 4.6.1, 4.6.2 and 4.6.3 of C&AG's Report No. 6 of 2006 (Union Government—Indirect Taxes-Performance Audit) and Paragraph No. 11.3 of C&AG's Report No. 7 of 2006 (Indirect Taxes). Then the representatives of the Ministry of Finance (Department of Revenue) and CBEC were called in and the Committee commenced the oral evidence. The Secretary, Department of Revenue and Member, CBEC explained the various points and queries raised by the Members. To certain queries, for which the witnesses could not give satisfactory reply, the acting Chairman directed that Ministry of Finance (Department of Revenue) might furnish the requisite information in writing at the earliest.

4. A copy of the verbatim proceedings of the sitting has been kept on record.

The Committee then adjourned.

ANNEXURE II

MINUTES OF THE TWELFTH SITTING OF PUBLIC ACCOUNTS COMMITTEE (2007-08) HELD ON 2ND NOVEMBER, 2007

The Committee sat from 1100 hrs. to 1250 hrs. in Committee Room 'C' Parliament House Annexe, New Delhi.

PRESENT

Prof. Vijay Kumar Malhotra — *Chairman*

Lok Sabha

2. Shri Khagen Das
3. Shri Raghunath Jha
4. Shri Bhartruhari Mahtab
5. Shri Brajesh Pathak
6. Shri K.S. Rao
7. Shri Tarit Baran Topdar

Rajya Sabha

8. Shri Prasanta Chatterjee
9. Dr. K. Malaisamy

SECRETARIAT

1. Shri A. Mukhopadhyay — *Joint Secretary*
2. Shri Brahm Dutt — *Director*
3. Shri M.K. Madhusudhan — *Deputy Secretary-II*
4. Shri R.K. Suryanarayanan — *Under Secretary*
5. Shri N.K. Jha — *Under Secretary*

Representatives of the office of the Comptroller and Auditor General of India

1. Shri B.K. Chattopadhyay — ADAI (RC)
2. Shri A.N. Chatterji — DG (PA)
3. Shri K.R. Sriram — PD (ESM)
4. Shri Jayanti Prasad — PD (INDT)
5. Shri R.B. Sinha — PD (AF&N)

Representatives of the Ministry of Consumer Affairs, Food and Public Distribution (Deptt. of Food and Public Distribution)

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Representative of the Food Corporation of India (FCI)

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Representative of the Planning Commission

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Representative of the Ministry of Rural Development (Department of Rural Development)

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Representative of Ministry of Housing and Poverty Alleviation

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2. At the outset, the Chairman, PAC welcomed the Members to the sitting of the Committee. Thereafter, the Committee took up for consideration, the following Draft Reports:

(a) Draft Report on Para 11.3 of C&AG Report No. 7 of 2006 [Indirect Taxes—Customs, Central Excise & Service Tax] relating to **"Under-valuation due to adoption of lower mutually agreed price."**

(b) Draft Action Taken Report on 28th Report of PAC (14th Lok Sabha) on **"Control Systems in India Security Press, Nashik."**

(c) Draft Action Taken Report on 34th Report of PAC (14th Lok Sabha) on **"Delayed purchase and insignificant utilization of equipment procured under Fast Track Procedure."**

After brief discussion, the Committee adopted the draft Reports without any modifications/amendments and authorized the Chairman to finalise and present the same to the Parliament in the light of factual verification done by the Audit.

3. *** *** *** *** *** ***

4. *** *** *** *** *** ***

5. *** *** *** *** *** ***

6. *** *** *** *** *** ***

The Committee then adjourned.

11.3 Undervaluation due to adoption of lower mutually agreed price

Section 4 as effective from 1 July 2000 brought the concept of transaction value. The Ministry in circular dated 30 June 2000 clarified that but for the normal value being replaced by transaction value, there was no difference in the scheme of valuation of petroleum products under the old section 4 and new section 4 and that the provisions of new section 4 when applied to the administered price of petroleum products should not make any material difference in assessable value.

Five terminals of M/s. IOCL at Bhatinda, Jalandhar, Jaipur, Jodhpur and Sangrur in Jaipur I, II, Ludhiana and Jalandhar commissionerates were engaged in storage and marketing of various petroleum products received in their bonded warehouse, stock of MS, HSD and SKO etc. from their refinieries. The IOCL terminals apart from clearing the products to their own distribution outlets also cleared MS, HSD and SKO etc.to terminals/depots belonging to other oil companies like M/s.BPCL and M/s. HPCL on payment of duty on assessable value which was much less than that charged from their own outlets/terminals.

It was observed that though the administered price mechanism was dismantled from April 2002, prices of petroleum products continued to be monitored and regulated by Oil Coordination Committee (OCC). Basic price structure of the products which formed the basis for determination of retail outlet prices charged from the ultimate consumer remained uniform for all the oil companies. As such adoption of lower assessable value at the stage of clearance of the products by IOCL installation to other oil companies resulted in lower duty reliaration clearance of products at lower (agreed) rates resulted in inflow of extra consideration to the other oil companies from ultimate consumers because the benefit of lower excise duty was not passed on to the ultimate consumer retail sale price having remained same. Accordingly, the price charged did not remain the sole consideration for sale and, hence, could not be considered as 'transaction value' for the purpose of levy of duty. The differential duty lost on the clearances of MS and HSD made to M/s. BPCL and M/s. HPCL terminals and their depots during April 2003 to September 2004 amounted to Rs. 27.76 crore.

On this being pointed out (between July 2003 and August 2004), the department in respect of two terminals (Bhatinda and Sangrur) intimated (May 2005) that SCNs for Rs. 5.90 crore covering clearance upto 31 March 2004 had been issued and in respect of Jalandhar and Jodhpur that SCNs were being issued. Reply in respect of Jaipur had not been received.

The Ministry stated (November 2005) that the transaction had taken place in accordance with an agreement entered into between IOCL and other oil marketing companies and the price charged was the sole consideration for sale. It further stated that the transactions satisfied the conditions laid down in section 4 leaving no ground for invoking the provisions of Valuation Rules.

Reply of the Ministry is not tenable as the price mutually agreed upon by the oil companies cannot be considered as transaction value in terms of section 4(i)(a) as products so cleared were actually sold by other petroleum companies at the same price at which their own products were sold. The clearance by IOCL to other oil companies at lower assessable value was thus not based upon purely commercial considerations and the assessable value was to be determined in terms of rule 11 read with rule 7 of the Valuation Rules.

MGIPMRND—4777LS—07-12-2007.