Malladi Drugs and Pharmaceuticals Ltd. Vs Union of India

Court: Madras High Court

Date of Decision: March 27, 2015

Acts Referred: Central Excises and Salt Act, 1944 - Section 11A, 11AC
Constitution of India, 1950 - Article 14, 19, 19(1)(g), 19(2)

Citation: (2015) 323 ELT 489

Hon'ble Judges: R. Sudhakar, J; T. Raja, J

Bench: Division Bench

Advocate: Arun Kurian Joseph, for the Appellant; T. Chandrasekaran, Senior Panel Counsel, Advocates for the Respondent

Judgement

@JUDGMENTTAG-ORDER

R. Sudhakar, J
This batch of writ petitions challenges the constitutional validity of Rule 8(3A) of the Central Excise Rules, 2002, which

was introduced with effect from 1-6-2006, and the said Rule reads as follows:-

8(3A). If the assessee defaults in payment of duty beyond thirty days from the due date, as prescribed in sub-rule (1), then notwithstanding

anything contained in said sub-rule (1) and sub-rule (4) of Rule 3 of Cenvat credit Rules, 2004, the assessee shall, pay excise duty for each

consignment at the time of removal, without utilizing the Cenvat credit till the date the assessee pays the outstanding amount including interest

thereon and in the event of any failure, it shall be deemed that such goods have been cleared without payment of duty and the consequences and

penalties as provided in these rules shall follow.

As a consequence, several proceedings were initiated, whereby show cause notices were issued for recovery of duty along with interest and

penalty from the defaulting assessees. Such proceedings are also the subject matter of challenge in some of the writ petitions in this batch. In some

of the cases, the assessees are also pursuing their cases either before the original authority or before the appellate forum. To be more precise, the

petitioners-assessees in W.P. Nos. 2506 of 2011, 4486 of 2009, 15585 of 2013, 19894 of 2010 & 27363 of 2012 have sought for a prayer to

declare the Rule 8(3A) of Central Excise Rules, 2002 ultra vires the object and scope of Central Excise Act and the Cenvat credit Scheme and

ultra vires Explanation to Rule 8(4) of the said rules and contrary to the instruction of the Board in the CBEC Manual as well ultra vires Articles 14

& 19 of the Constitution of India. The petitioners-assessees in W.P. Nos. 4487 of 2009, 20938 of 2009, 20093 to 20103 of 2010, 22314 of

2010, 25236 of 2011, 28678 of 2011 & 27364 of 2012 have challenged the show cause notices as arbitrary, illegal, null and void, unsustainable,

without authority and bad in law. The petitioners-assessees in W.P. Nos. 19893 of 2010 and 15586 of 2013 have challenged the final orders

passed by the original authority and the petitioner-assessee in W.P. No. 1864 of 2012 has challenged the interim order passed by the appellate

authority in demanding the pre-deposit of the entire duty along with interest for entertaining the appeal.

The primary ground of challenge made in this batch of writ petitions is that Rule 8(3A) of the Central Excise Rules, 2002 is unconstitutional, totally

arbitrary, irrational, oppressive and contrary to the power delegated to the rule making authority. Several facets of the challenge to the said rule

was considered by a Division Bench of the Gujarat High Court in the case of Indsur Global Ltd. Vs. Union of India, (2014) 310 ELT 833 ,

wherein the Court declared that the condition contained in sub-rule (3A) of Rule 8 for payment of duty without utilizing the Cenvat credit till an

assessee pays the outstanding amount including interest is unconstitutional. To be more precise, the Court held as follows:-

36. In the result, the condition contained in sub-rule (3A) of Rule 8 for payment of duty without utilizing the Cenvat credit till an assessee pays the

outstanding amount including interest is declared unconstitutional. Therefore, the portion ""without utilizing the Cenvat credit"" of sub-rule (3A) of

Rule 8 of the Central Excise Rules, 2002, shall be rendered invalid.

2. The Gujarat High Court, while considering the challenge to the above rule in Indsur Global Ltd., primarily proceeded to hold so on the basis of

two decisions of the Supreme Court, one in the case of Eicher Motors Ltd. v. Union of India, 1999 (106) E.L.T. 3 (S.C.) and another in the case

of Collector of Central Excise, Pune Etc. Etc. Vs. Dai Ichi Karkaria Ltd. Etc. Etc., AIR 1999 SC 3234 : (1999) 65 ECC 354 : (1999) ECR 4 :

(1999) 112 ELT 353 : (1999) 5 JT 595 : (1999) 4 SCALE 669 : (1999) 7 SCC 448 : (1999) 1 SCR 360 Supp : (1999) AIRSCW 3205 :

(1999) 7 Supreme 456 . It also came to the view that the restriction imposed under sub-rule (3A) of Rule 8 to pay the excise duty without availing

Cenvat credit was an unreasonable restriction, inter alia, holding that it prevents an assessee from availing credit of duty already paid by him. It was

also of the view that such a mechanism to provide for withdrawal of Cenvat credit facility for paying the duty borders to creating a penalty. For

better clarity, we set out the relevant portions of the judgment in Indsur Global Ltd., as follows:-

29. This brings us to the last limb of the petitioner''s contention, namely, that the condition attached by sub-rule (3A) of Rule 8 is unreasonable and

therefore violative of Article 14 of the Constitution and amounts to serious restriction on the petitioner''s right to carry on trade or business of his

choice guaranteed under Article 19(1)(g) of the Constitution. This contention requires a closer scrutiny. As noted earlier, the restrictions of sub-rule

(3A) come in two folds. Firstly, a defaulter assessee has to clear the consignments on spot payment of excise duty and secondly, that such excise

duty has to be paid in cash without availing Cenvat credit. This rule does not make any distinction between the willful defaulter and the others.

Though term ''willful defaulter'' has not been defined in the statute, the concept is not an unknown one. Section 11AC of the Central Excise Act

provides for penalty in case of non-levy, short levy or non-payment or short payment or erroneous refund of the duty where the same is

occasioned by reason of fraud or collusion or any willful mis-statement or suppression of facts or contravention of any of the provisions of the Act

or the rules made thereunder with an intent to evade payment of duty. Likewise, Section 11A which pertains to recovery of duties not levied or not

paid or short levied or short paid or erroneously refunded makes a clear distinction when it gives the period of limitation available to the

department to institute proceedings, in such cases between such non-payment having been occasioned due to fraud, collusion, etc. in which case a

longer period of limitation is available as against rest of the cases. Likewise, under Rule 12CC of the Central Excise Rules as it stood at the

relevant time, power was given to the Government by notification to withdraw facilities from the manufacturers, registered dealers or exporters

under certain circumstances having regard to the extent of evasion of duty, nature and type of offences or such other factors as has been relevant.

In exercise of such powers, notification No. 17/2006 was issued providing for withdrawal of facilities and for imposition of restrictions against who

are prima facie found to be knowingly involved in any of the following:

(a) removal of goods without the cover of an invoice and without payment of duty;

(b) removal of goods without declaring the correct value for payment of duty, where a portion of sale price, in excess of invoice price, is received

by him or on his behalf but not accounted for in the books of account;

(c) taking of Cenvat credit without the receipt of goods specified in the document based on which the said credit has been taken;

(d) taking of Cenvat credit on invoices or other documents which a person has reasons to believe as not genuine;

(e) issue of excise duty invoice without delivery of goods specified in the said invoice;

(f) claiming of refund or rebate based on the excise duty paid invoice or other documents which a person has reason to believe as not genuine.

This Rule 12CC as well as the notification issued by the Government would apply to special class of assessees who through their conscious act

tried to evade duty.

30. It can be seen that the reasons for non-payment of excise duty can be manifold and not necessarily in all cases have to be willful default by an

assessee despite availability of funds. Excise duty may remain unpaid due to economic reasons, due to slowness in the business or due to financial

crunch temporarily felt by the manufacturer who though might have cleared the finished goods and also sold the goods in the market may not have

received the payment as promised. All such cases of defaults willful or otherwise are clubbed together for the same treatment and a stringent

condition of payment of excise duty without availing Cenvat credit is imposed. It can be appreciated that where a manufacturer falls behind the

payment schedule on account of financial constraints, such as, slowing down of business, competition in the market reducing the profit margins,

promised payments from the purchasers not coming forth or temporary labour disputes, would find it extremely difficult thereafter to raise further

funds for payment of duty in addition to the duty which he has already paid. Cenvat credit is available to a manufacturer upon purchase of inputs

which are duty paid. It is the duty element which the assessee has already suffered which is credited to his Cenvat credit account available to him

for adjustment for payment of excise duty liability upon clearance of the finished product. If such facility is withdrawn, it could be appreciated, his

ability to continue the business under such adverse financial climate would further diminish. This would be a cyclical vicious pattern where in every

month he would fall behind by the due date unable to raise cash flow for payment of duty for the clearance which he desires to make and is

therefore further saddled with the burden of paying such duty in cash without availing CENVAT credit. This rule thus imposes a wholly

unreasonable restriction which is not commensurate with the wrong sought to be remedied.

31. This extreme hardship is not the only element of unreasonableness of this provision. It essentially prevents an assessee from availing Cenvat

credit of the duty already paid and thereby suspends, if not withdraws, his right to take credit of the duty already paid to the Government. It is true

that such a provision is made because of peculiar circumstances the assessee lands himself in. However, when such provision makes no distinction

between a willful defaulter and the rest, we must view its reasonableness in the background of an ordinary assessee who would be hit and targeted

by such a provision. As held by the Supreme Court in the case of Eicher Motors Ltd. (supra) an assessee would be entitled to take credit of input

already used by the manufacturer in the final product. In the said case, the Supreme Court was dealing with Rule 57F which was introduced in the

Central Excise Rules, 1944 under which credit lying unutilized in the Modvat credit account of an assessee on 16th March 1995 would lapse. Such

provision was questioned. The Supreme Court held that since excess credit could not have been utilized for payment of the excise duty on any

other product, the unutilised credit was getting accumulated. For the utilization of the credit, all vestitive facts or necessary incidents thereto had

taken place prior to 16-3-1995. Thus the assessees became entitled to take the credit of the input instantaneously once the input is received in the

factory of the manufacturer of the final product and the final product which had been cleared from the factory was sought to be lapsed. The

Supreme Court struck down the rule further observing that if on the inputs the assessee had already paid the taxes on the basis that when the

goods are utilized in the manufacture of further products as inputs thereto then the tax on those goods gets adjusted which are finished

subsequently. Thus a right had accrued to the assessee on the date when they paid the tax on the raw materials or the inputs and that right would

continue until the facility available thereto gets worked out or until those goods existed. We may also recall that in the case of Dai Ichi Karkaria

Ltd. (supra) it was reiterated that a manufacturer obtains credit for the excise duty paid on raw material to be used by him in the production of an

excisable produce immediately it makes the requisite declaration and obtains an acknowledgment thereof. It is entitled to use the credit at any time

thereafter when making payment of excise duty on the excisable product.

32. As held by the Supreme Court in the case of Chantamanrao (supra), the phrase ""reasonable restriction"" connotes that the limitation imposed on

a person in enjoyment of the right should not be arbitrary or of an excessive nature, beyond what is required in the interests of the public.

Legislation which arbitrarily or excessively invades the right cannot be said to contain the quality of reasonableness and unless it strikes a proper

balance between the freedom guaranteed in Article 19(1)(g) and the social control permitted by clause (6) of Article 19, it must be held to be

wanting in that quality.

33. In the case of Om Kumar (supra), the Supreme Court recognized the applicability of the principle of proportionality in judging the validity of a

provision on the touchstone of reasonableness under Article 14 of the Constitution. It was observed:

53. Now under Art. 19(2) to (6), restrictions on fundamental freedoms can be imposed only by legislation. In cases where such legislation is made

and the restrictions are reasonable yet, if the concerned statute permitted the administrative authorities to exercise power or discretion while

imposing restrictions in individual situations, question frequently arises whether a wrong choice is made by the Administrator for imposing restriction

or whether the Administrator has not properly balanced the fundamental right and the need for the restriction or whether he has imposed the least

of the restrictions or the reasonable quantum of restriction etc. In such cases, the administrative action in our country, in our view, has to be tested

on the principle of ''proportionality,'' just as it is done in the case of the main legislation. This, in fact, is being done by our Courts.

34. By no stretch of imagination, the restriction imposed under sub-rule (3A) of Rule 8 to the extent it requires a defaulter irrespective of its extent,

nature and reason for the default to pay the excise duty without availing Cenvat credit to his account can be stated to be a reasonable restriction. It

leads to a situation so harsh and a position so unenviable that it would be virtually impossible for an assessee who is trapped in the whirlpool to get

out of his financial difficulties. This is quite apart from being wholly reasonable, being irrational and arbitrary and therefore, violative of Article 14 of

the Constitution. It prevents him from availing credit of duty already paid by him. It also is a serious affront to his right to carry on his trade or

business guaranteed under Article 19(1)(g) of the Constitution. On both the counts, therefore, that portion of sub-rule (3A) of rule must fail.

35. The situation can be looked at slightly different angle. With or without the provisions of sub-rule (3A), liability to pay interest for the default

period as per sub-rule (3) of Rule 8 continues. Sub-rule (3A) is basically a mechanism for stringent recovery and does not create a new liability

unless this mechanism itself is breached. In such a mechanism to provide for withdrawal of Cenvat credit facility for paying the duty borders to

creating a penalty. Insisting on an assessee in default to clear all consignments on payment of duty would be a perfectly legitimate measure.

However, to insist that he must pay such duty without utilising Cenvat credit which is nothing but the duty on various inputs already paid by him

would be a restriction so harsh and out of proportion to the aim sought to be achieved, the same must be held to be wholly arbitrary and

unreasonable. We may recall, the delegated legislature in its wisdom now dismantled this entire mechanism and instead has provided for penalty at

the rate of 1% per month on delayed payment of duty.

36. In the result, the condition contained in sub-rule (3A) of Rule 8 for payment of duty without utilizing the Cenvat credit till an assessee pays the

outstanding amount including interest is declared unconstitutional. Therefore, the portion ""without utilizing the Cenvat credit"" of sub-rule (3A) of

Rule 8 of the Central Excise Rules, 2002, shall be rendered invalid.

The relevant portion of Rule 8(3A) has been held to be ultra vires by the Gujarat High Court. We are in agreement with the reasoning of the

Gujarat High Court. We, however, would also like to add our view as to why such a restriction imposed under sub-rule (3A) of Rule 8 of the

Central Excise Rules is totally untenable.

3. The availment of Cenvat credit is a right that accrues to an assessee and denial of such credit can be made only by procedure prescribed by the

law. The implication of Cenvat credit and the utilisation thereon has been clearly highlighted by the Supreme Court in paragraph-17 of the judgment

in Collector of Central Excise, Pune Etc. Etc. Vs. Dai Ichi Karkaria Ltd. Etc. Etc., AIR 1999 SC 3234 : (1999) 65 ECC 354 : (1999) ECR 4 :

(1999) 112 ELT 353 : (1999) 5 JT 595 : (1999) 4 SCALE 669 : (1999) 7 SCC 448 : (1999) 1 SCR 360 Supp : (1999) AIRSCW 3205 :

(1999) 7 Supreme 456 , and it reads as follows:-

17. It is clear from these Rules, as we read them, that a manufacturer obtains credit for the excise duty paid on raw material to be used by him in

the production of an excisable product immediately it makes the requisite declaration and obtains an acknowledgment thereof. It is entitled to use

the credit at any time thereafter when making payment of excise duty on the excisable product. There is no provision in the Rules which provides

for a reversal of the credit by the excise authorities except where it has been illegally or irregularly taken, in which event it stands cancelled or, if

utilised, has to be paid for. We are here really concerned with credit that has been validly taken, and its benefit is available to the manufacturer

without any limitation in time or otherwise unless the manufacturer itself chooses not to use the raw material in its excisable product. The credit is,

therefore, indefeasible. It should also be noted that there is no co-relation of the raw material and the final product; that is to say, it is not as if

credit can be taken only on a final product that is manufactured out of the particular raw material to which the credit is related. The credit may be

taken against the excise duty on a final product manufactured on the very day that it becomes available.

(emphasis supplied)

4. It is not the case of the Department in this batch of writ petitions that the petitioners-assessees have illegally or irregularly taken the Cenvat

credit. It is to be mentioned herein that sub-rule (1) of Rule 8 provides for the manner of payment of duty on the goods removed from the factory

or the warehouse as provided thereunder. Sub-rule (2) of Rule 8 extends the benefit of duty to the third party purchaser, who buys the excisable

goods removed by the assessee and such goods are deemed to have suffered duty of excise. Under sub-rule (3) of Rule 8, interest is liable to be

paid on the outstanding amount, if the assessee fails to pay the duty by the due date. In contradiction to this procedure, sub-rule (3A) of Rule 8

provides that in default of the payment of duty beyond thirty days from the due date as prescribed under sub-rule (1), notwithstanding anything

contained in sub-rule (1) and sub-rule (4) of Rule 3 of Cenvat Credit Rules, 2004, the assessee is bound to pay excise duty at the time of removal

without utilizing the Cenvat credit till the date the assessee pays the outstanding amount including interest thereon. The right to pay duty by utilising

the Cenvat credit that had accrued cannot be defeated, unless it is a case of illegal or irregular credit (See the decision of the Supreme Court in Dai

Ichi Karkaria Ltd., referred supra). To that extent, we find this sub-rule (3A) arbitrary and therefore violative of Article 14. The right that has

accrued to an assessee by way of Cenvat credit, that is duty paid on the inputs, cannot be taken away under a rule, which only provides for the

manner and method of payment of duty and for levying of interest, if there is a default. The object of the term ""without utilizing the Cenvat credit

would run counter to the scheme of availment of the Cenvat credit on the duty paid inputs. It is a legitimate right that has accrued to an assessee

and that cannot be denied arbitrarily under the provision under challenge. We, therefore, have no hesitation to concur with the reasoning of the

Gujarat High Court that Rule 8(3A) is ultra vires of Article 14 on the ground of arbitrariness.

5. Now coming to the challenge to the proceedings initiated by the Department by invoking Rule 8(3A) of the Central Excise Rules, 2002 and the

consequential orders passed by the original authority or appellate authority, as the case may be, in demanding duty along with interest, the Gujarat

High Court in the case of Precision Fasteners Ltd. Vs. Commissioner of Central Excise , has held as follows:-

4. When the statutory basis for issuance of a show cause notice and raising tax demand is knocked down, the very proceedings would have to be

struck down.

5. Learned counsel Shri Oza for the revenue, however, submitted that during the pendency of this petition, the adjudicating authority passed the

final order which has not been challenged. He drew our attention to the later portion of the said decision in case of Indsur Global Ltd. (supra) in

which this Court even while striking down the portion of sub-rule (3A) of Rule 8, did not disturb the orders passed by the Revenue authorities as

upheld by the Tribunal, since such dispute had achieved finality. Counsel would urge that in the present case also the same course should be

adopted.

6. In our opinion, however, there is vital difference between the two sets of facts. In the present case, the petitioner had raised the challenge to the

statutory provisions even before the Adjudicating Authority had taken a final decision. He had, along with rule, also challenged the show cause

notice. In the case of Indsur Global Ltd. (supra) the petitioner had unsuccessfully challenged the order of the Adjudicating Authority. The appeal

was dismissed by the Commissioner on the ground of delay beyond his power to condone. The Tribunal had dismissed further appeal on the

ground of gross delay of three years in preferring the appeal before the Tribunal as also on the ground that in any case the Commissioner was right

in not entertaining the appeal of the assessee which was presented along with the application for condonation of delay after the maximum period

which the Commissioner could have condoned. It was in this background the Court held that the issues which are closed cannot be reopened. It

was noted that there were other proceedings between the same assessee and department pending at various stages on same issue. It was,

therefore, provided that the particular order in challenge would not be disturbed but that the benefit of declaration of invalidity of the rule would be

available to the petitioner in other pending proceedings.

7. In view of such clear distinction in facts, the modus adopted in the said case in case of Indsur Global Ltd., (supra) cannot be applied in the

present case. The impugned tax demands and show cause notice are set aside. Resultantly, all subsequent actions, if any, taken by the department

would be set at naught. Petition is allowed. Rule is made absolute accordingly.

In the light of the aforesaid judgment of the Gujarat High Court, to which view we are agreeable, all the proceedings initiated by the Department in

respect of the respective assessees, invoking the said rule by demanding duty along with interest by denying the benefit of Cenvat credit have to be

necessarily set aside. Accordingly, the impugned proceedings are set aside. In the result, all the writ petitions are allowed. Consequently, M.P.

Nos. 1 of 2009, 1 of 2010, 1 of 2011, 1 of 2012 & 1 of 2013 are closed. However, there is no order as to costs.