

A M/S PEPSI FOODS LTD.
v.
COLLECTOR OF CENTRAL EXCISE, CHANDIGARH

NOVEMBER 25, 2003

B [P. VENKATARAMA REDDI AND DR. AR. LAKSHMANAN, JJ.]

Central Excise and Salt Act, 1944 : Section 4(a).

C *Excise Duty—AYs 1992-93 and 1993-94—Sole consideration for sale—Royalty amount—Inclusibility of—In assessable value of goods—Assessee sold ‘concentrate’ to bottlers out of which the bottlers manufactured soft drink beverages—Assessee collected royalty amount from these bottlers for use of its trademark—Held : The sale of ‘concentrate’ and payment of royalty were integral operations and could not be dissociated from each other—The invoice price of ‘concentrate’ alone was not the sole consideration for sale of ‘concentrate’—It also included royalty amount—Hence, royalty amount includible in the assessable value of the ‘concentrate’.*

Words and Phrases :

E *“Sole consideration for sale”—Meaning of—In the context of S. 4(a) of the Central Excise and Salt Act, 1944.*

F **The appellant-assessee sold ‘concentrate’ to the bottlers out of which soft drink beverage under the trademark ‘lehar’ was manufactured by the said bottlers. The appellant and the bottlers were governed by an agreement under which the appellant received royalty amount from the bottlers, calculated at a certain percentage of the beverage bottles despatched from the plant.**

G **The appellant filed pricelists of their product for the AYs 1992-93 and 1993-94 before the Assistant Collector of Central Excise and Customs who proposed to include the royalty amount in the assessable value of the ‘concentrate’ and demanded duty on that basis.**

H **The adjudicating officer took the view that the sale of the ‘concentrate’ was interlinked with the royalty charges inasmuch as the**

'concentrate' was sole only to those who agreed to pay for the brand name. The appellant Collector rejected the appellant's appeal, which was upheld by the Central Excise, Customs and Gold (Control) Appellate Tribunal. Hence the appeal. A

On behalf of the appellant, it was contended that the sale of 'concentrate' by the appellant to the bottler and the collection of royalty from the bottler for the use of the trademark were two different transactions and there was no nexus between them; that the payment of royalty was directly related to the use of the trademark and that the royalty was paid when the bottle was moved out from the plant of the bottler and it had nothing to do with the sale value of the 'concentrate' B C

The following question arose before the Court :

Whether the royalty amount collected by the appellant-assessee from the bottlers for use of the trademark 'lehar' on the soft drink beverages manufactured out of the 'concentrate' sold by the appellant is includible in the assessable value of the 'concentrate'? D

Dismissing the appeal, the Court

HELD : 1.1. The Agreement between the appellant-assessee and the bottler sets in motion a series of steps aimed at promoting the appellant's business in collaboration with the bottler and also realizing the royalty. The agreement makes it clear that the realization of royalty was as important as the realization of the sale price of the concentrate from the assessee's point of view. In reality and in substance, the component of royalty cannot be dissociated from the ostensible consideration for the sale of 'concentrate' by the assessee. The assessee would not have parted with the goods, namely, 'concentrate' if the royalty payment did not enter into the bargain. The bottler is obliged to purchase the 'concentrate' from the assessee and assessee alone, use the trademark of the assessee on the bottled beverage in addition to the trademark of Pepsico and comply with the instruction of the assessee in regard to manufacture, sale and distribution of beverages. There is an element of control in respect of the entire business operations of the bottlers. There exists an inextricable bond between the obligation of the E F G H

A bottler to purchase the 'concentrate' exclusively from the assessee and the user of trademark of the assessee subject to payment of royalty. The royalty, which is realizable as a consideration for authorizing the use of the trademark, cannot, therefore, be viewed in isolation. The appellant's sale of 'concentrate', the bottler's manufacture of beverages out of that and the sale thereof by using the assessee's trademark are all integral operations. [237-F-H; 238-A-H; 239-A-F]

1.2. The assessee very well visualized that the consideration in the form of royalty would flow to it by virtue of the supply of the 'concentrate'. The substratum of the agreement regulating the terms of dealings between the parties unmistakably indicate that the invoice price alone was not the sole consideration for the sale of 'concentrate'. [239-G-H]

2.1. The fact that the royalty is charged for permitting the use of the trademark, but not as part of price for specific units of 'concentrate' sold, does not detract from the fact that the overall consideration for the sale of 'concentrate' is not merely its price stated in the invoice. It is something more than that, namely; royalty to be received periodically. [240-A]

2.2. Under the agreement, the obligation to buy the 'concentrate' at the price fixed by the seller (appellant) and the obligation of the buyer to manufacture the bottled soft drinks, to sell the same by using the trademark of the appellant and to remit the prefixed royalty charges is inseparable from on another. [240-B-C]

F *Union of India v. Mahindra & Mahindra Ltd.*, (1995) 76 E.L.T. 481 SC, *Collector of Customs, Bombay v. Maruthi Udyog Ltd.*, (1987) 28 E.L.T. 390 and *Duke & Sons v. Commissioner of Central Excise*, (1991) 55 E.L.T. 577, held inapplicable.

G CIVIL APPELLATE JURISDICTION : Civil Appeal No. 4051 of 1996.

From the Judgment and Order dated 18.10.95 of the Central Excise Customs and Gold (Control) Appellate Tribunal, New Delhi in F.O. No. 536 of 1995-A.

H WITH

C.A. No. 1385 of 1999. A

V. Lakshmikumaran, Madhav Rao, Ashok Yadav and D.N. Mehta for Ms. Suruchi Agarwal for the Appellants.

Dileep Tandon, K.C. Kaushik for B.K. Prasad, U.A. Rana and Arvind Kumar for the Respondent B

The Judgment of the Court was delivered by

P. VENKATARAMA REDDI, J. The question raised in these appeals filed by the assessee under Section 35L(b) of the Central Excise Act is whether the royalty amount collected by it from the bottlers for use of the trademark 'lehar' on the soft drink beverages manufactured out of the 'concentrate' sold by the appellant is includible in the assessable value of the concentrates. The appellant and its buyers (hereinafter referred to as 'the bottlers') are governed by an agreement captioned as "PFL Bottling Appointment and Trademarks Licence Agreement With Bottlers", the terms of which we shall advert to later. C
D

For the period 1.9.1992 to 31.3.1993 (which is covered by C.A.No.4051 of 1996) and for the period 1.4.1993 to 31.12.1993 (which is covered by C.A.No. 1385 of 1999), the appellant filed pricelists of their product. On perusal of the details furnished with the pricelist, the Department became aware of the fact that royalty charges were being received by the appellant under the terms of an agreement permitting the use of trademark 'lehar'. The Assistant Collector of Central Excise and Customs, Patiala issued show cause notices proposing the inclusion of the royalty charges in the assessable value and demanding duty on that basis. We are not concerned here with the advertising expenses which was also the subject matter of show cause notices issued for the earlier period. The objections filed by the appellant-assessee were overruled by the adjudicating authority and orders were passed approving the pricelists subject to the addition of royalty charges and advertising expenses and demanding differential duty for the clearances made during the said period. The adjudicating officer took the view that the sale of the concentrate was interlinked with the royalty charges inasmuch as the concentrate is sold only to those who agree to pay for the brand name. The appellate Collector rejected the assessee's appeal and confirmed the order of adjudication. On further appeal to the E
F
G
H

A Tribunal, no relief was granted as regards the royalty charges though the appeal was allowed in regard to the other disputed items. The Tribunal observed thus:

B “It is thus plain that the licence to use the appellant’s trademark is granted to the bottlers bound up with obligation to purchase the concentrate only from the appellants. The two are inextricably intertwined. The agreement with the bottlers is thus an indivisible and composite agreement for the sale of concentrate to them by the appellants and for the grant of licence to them for the use of the appellant’s trademark on the beverages manufactured by the
C bottlers.”

This decision of the Tribunal which is the subject matter of appeal in C.A. 4051 of 1996 was followed by the Tribunal in respect of the subsequent period. C.A. No. 1385 of 1999 is preferred against that order.

D The learned counsel for the appellant strenuously contended that the sale of concentrate by the appellant to the bottler and the collection of royalty from the bottler for the use of the trademark are two different transactions and there is no nexus between them. The payment of royalty
E is directly related to the use of trademark and it is realized as a percentage of the maximum retail price of the soft drink sold by the bottlers. Thus, royalty is paid when the bottle is moved out from the plant of the bottler and it has nothing to do with the sale value of the concentrate. In fact, the bottlers while fixing the M.R.P. take into account the royalty paid to the
F appellant and the excise duty is paid by the bottler on the price inclusive of royalty. Though this fact by itself has no bearing on the question involved, according to the learned counsel, it would only indicate that there was no loss of revenue. The counsel for the appellant laid emphasis on the fact that the royalty is being collected on the sales of soda effected by the bottler with the trademark of the assessee though the base material was not
G supplied by the assessee. Both the counsel have relied on the terms of the agreement to buttress their arguments. The counsel for the respondent has relied on the findings of the Tribunal and contended that the price at which the beverage base is sold to the bottler is not the sole consideration and an additional consideration of 2.75% of the MRP on each bottle flows back
H to the appellant. It is contended that the sale of beverage base is inextricably

linked to the use of the trademark on the beverage bottles when sold and they are not independent transactions. A

Section 4 of the Central Excise and Salt Act, 1944 (as it stood at the relevant time) lays down the mode of valuation of excisable goods for the purpose of charging the excise duty. When such duty is chargeable under the Act with reference to the value of the goods, the value shall, subject to the other provisions of the Section, "be deemed to be the normal price" thereof, that is to say— B

"the price at which such goods are ordinarily sold by the assessee to a buyer in the course of wholesale trade for delivery at the time and place of removal, where the buyer is not a related person and *the price is the sole consideration for the sale.* (emphasis supplied) C

The provisos are not relevant for our purpose. Clause (b) of Section 4 lays down that— D

"where the normal price of such goods is not ascertainable for the reason that such goods are not sold or for any other reason, the nearest ascertainable equivalent thereof determined in such manner as may be prescribed." E

The manner of ascertainment of the value in terms of clause (b) is provided for by Central Excise (Valuation) Rules. On the premise that the price is not the sole consideration for the sale of concentrate, the Central Excise authority resorted to valuation in accordance with the valuation rules. F

The crucial question is whether the price charged by the assessee at the time of sale of concentrate to the bottlers represents the sole consideration for the sale or whether, apart from the invoice price, any other monetary consideration was contemplated by the parties is the question? In other words, can it be said that the realization of the royalty at the agreed rate from the bottler was essential part of the bargain that led to the sale of concentrate? The answer to this does not depend on the question: whether the price of concentrate has been understated. Even in the absence of such a contingency, the last clause of Section 4(1)(a) would come into play and if under the terms of Agreement, an extra consideration would eventually H G

A flow back to the assessee/manufacturer as an inevitable consequence of sale of concentrate, it cannot then be said that the price is the sole consideration for sale. However, there should be intimate nexus between the sale and realization of royalty.

B Now, let us turn to the salient features of Agreement in order to appreciate the issue in its proper perspective.

The Agreement is captioned as "PFL Bottling Appointment and Trademarks Licence Agreement With Bottlers". The assessee Company grants licence to use the trademark 'Lehar' in conjunction with the trademarks called 'Pepsico Marks' owned by Pepsico Inc., USA. This licence is in respect of beverage products. Certain territory is assigned to each bottler and the bottler can use the said trademark within the territory. In consideration of the licence granted for use of the trademark, the bottler shall pay a royalty at the rate of 2.75% of the maximum retail price of the beverage as notified by the bottler. The royalty will be payable at the above rate for each bottle of the beverage dispatched by the bottler from the plant. The royalty shall be paid to the assessee Company at New Delhi within 15 days of the end of each calendar month in respect of sales made during such calendar month. At the end of each financial year, the bottler shall submit an audit certified statement showing the amounts payable by the bottler towards royalties. The bottler shall buy all units of concentrate required for the manufacture of the beverage only from Pepsico's approved manufacturer, PFL (the assessee), or a manufacturer approved in writing by Pepsico and PFL at a price and in accordance with the terms and conditions established by the seller. The bottler will strictly follow all instructions and directions issued by assessee Company from time to time for preparing, bottling, selling and distributing the beverage including the quality and standards of bottles, cartons and containers. The bottler will undertake appropriate advertising and sales promotion activities for the beverage. The agreement shall not create or to be deemed to create any relationship of agency, partnership or joint venture. The agreement shall terminate automatically upon the termination of the arrangement between Pepsico and the bottler for the use of the 'Pepsico Marks'. Upon the termination of the agreement in the manner provided for, the bottler will not use any of the trademarks, names, symbols, emblems or designs of the assessee Company. Further, on such termination, the assessee Company

shall have the right to purchase from the bottler any part or all of the bottler's beverage bottles, crowns, labels, containers, cases, cartons, unused advertising material and concentrate at the invoice price less a reasonable allowance for depreciation. In the event the bottler appoints wholesale distributors, the bottler will be obligated to ensure that the distributors fully comply with all the terms and conditions of the agreement relating to the sale and distribution of the beverage.

It is fairly clear that the agreement sets in motion series of steps aimed at promoting the appellant's business in collaboration with the bottler and also realizing the royalty calculated at a prescribed percentage of the retail price of every bottle. The agreement, read as a whole, makes it clear that the realization of royalty was as important as the realization of the sale price of the concentrate from the assessee's point of view. In reality and in substance, the component of royalty cannot be dissociated from the ostensible consideration for the sales of concentrate by the assessee. The assessee would not have parted with the goods, namely, concentrate if the royalty payment did not enter into the bargain. The bottler is obliged to purchase the concentrate from the assessee and assessee alone, use the trademark of the assessee on the bottled beverage in addition to the trademark of Pepsico and comply with the instructions of the assessee in regard to manufacture, sale and distribution of beverages. There is an element of control in respect of the entire business operations of the bottlers. There exists an inextricable bond between the obligation of the bottler to purchase the concentrate exclusively from the assessee and the user of trademark of assessee subject to payment of royalty. The royalty which is realizable as a consideration for authorizing the use of trademark cannot, therefore, be viewed in isolation. The appellant's sale of concentrate, the bottler's manufacture of beverages out of that and the sale thereof by using assessee's trademark are all integral operations. It is in this background, we have to judge whether the invoice price is the sole consideration contemplated by the parties for the sale and purchase of concentrate. The assessee very well visualized that the consideration in the form of royalty would flow to it by virtue of supply of the concentrate. In our view, the substratum of the agreement regulating the terms of dealings between the parties unmistakably indicate that the invoiced price alone was not the sole consideration for the sale of concentrate. The finding of the Tribunal is, therefore, unexceptionable.

A The fact that the royalty is charged for permitting the use of the trademark, but not as part of price for specific units of concentrate sold does not detract from the fact that the overall consideration for the sale of concentrate is not merely its price stated in the invoice. It is something more than that, namely, royalty to be received periodically.

B Under the agreement, the obligation to buy the concentrate at the price fixed by the seller (appellant) and the obligation of the buyer to manufacture the bottled soft drinks, to sell the same by using the trademark of the appellant and to remit the prefixed royalty charges is inseparable from one another.

C It is however contended that in respect of Soda manufactured by the bottlers on their own, the appellant collects royalty from them for the use of the trademark 'lehar' even though there was no sale of any raw material. According to the learned counsel for the appellant, this is a strong indicia that the licence to use the trademark granted to the bottler in consideration of receiving the royalty is an independent and distinct transaction. No such specific plea was raised before any of the authorities including the Tribunal, though there was demur to the inclusion of royalty received on the sales of soda by the manufacturer. The documents relating to the collection of royalty on account of the sale of soda with the trademark of the appellant are not on record. The circumstances in which such a deal was entered into are not apparent from the record. We do not, therefore, propose to delve into this aspect further. We may mention that the appellant's claim for exclusion of royalty received on Soda sales was accepted by the Tribunal.

F In our view, none of the decisions cited by the learned counsel for the appellant will come to the aid of the appellant though there are certain overlapping features.

G The first case relied upon is the *Union of India v. Mahindra & Mahindra Ltd.*, (1995) 76 E.L.T. 481 (S.C.). This case was rightly distinguished by the Tribunal. It was found as a matter of fact that there was no material to indicate any nexus or connection between the lumpsum payment of 15 million French Francs paid by the assessee to the foreign collaborator for providing the use of 'PEUGEOT Engine Technology' and

H

the supply of CKD packs to the respondents by PEUGEOT for the production of the engine. This Court observed — A

“In no sense, it can be stated that the price of the goods obtained later was reckoned or reflected in the lumpsum payments made, long before. The parties never had in mind the nature and extent of the spare parts that may be required later, when the collaboration agreement was entered into.” B

The fact that there was no obligation on the assessee to purchase CKD packs at all, that long before the supply of the CKD packs and spares, the royalty due to the collaborators was paid, that there was no material to show that the supply of the CKD packs or spares weighed with the parties in fixing the payments under the collaboration agreement were all taken into account by the Court to conclude that no nexus existed between the lumpsum payment under the agreement for the technical know-how and the determination of the price for supply of CKD packs/spares. The distinguishing features are many and the appellant cannot draw any support from that case. C D

The decision of CEGAT in *Collector of Customs, Bombay v. Maruthi Udyog Ltd.*, (1987) (28) E.L.T. 390 has also been relied upon. The special leave petition filed against this order was dismissed *in limine* by this Court on 26.4.1989 by a non speaking order. This case also does not help the appellant. In this case, the contention of the Department that the import invoice price pertaining to components, assemblies and vehicles was not the sole consideration for the sale but the royalties relatable to the manufacture in India of Suzuki's components also constitutes the consideration for the purchase of the imported goods was not accepted. The Tribunal held that the royalty payments were relatable directly to the manufacture of goods in India and they had no nexus with the import of goods from Japan. It was observed that “neither royalty nor the trademark ‘Maruthi Suzuki’ had anything to do with import of components, assemblies and vehicles from Japan”. The ratio of that decision of CEGAT thus stands on a different footing. E F G

One more case on which reliance was sought to be placed by the appellant's counsel is the order of CEGAT in *Duke & Sons v. Commissioner* H

A of *Central Excise*, (1991) (55) ELT 577 which stood affirmed by this Court by reason of dismissal of S.L.P. That was also a case of franchise fees payable by the buyers of concentrate to the assessee for using the trademark of the assessee on the soft drink bottles. The Tribunal made the following crucial observations:

B “The agreement under which the buyers are permitted to use the trademark is not filed either before the lower authorities or before us. Therefore, no views can be expressed as to whether it is interlinked with the sale of ‘concentrate’. There is also no evidence on record to indicate that the ‘concentrate’ is sold only to those who also enter into agreement to buy the ‘trademark’. In other words, there is no evidence to establish that the agreement to purchase trademark is essential before a buyer purchases the ‘concentrate’. Similarly, there is no evidence that a buyer is not willing to purchase the ‘concentrate’ without purchasing the trademark. In other words, there is no evidence to establish that the sale of concentrate is dependent on the purchase of trademark. In the absence of such evidence it is difficult to hold that the sale of concentrate is interlinked or closely connected and without the sale of trademark there is no sale of concentrate.”

E It was under those circumstances the royalty payment was excluded from the assessable value of the concentrate. The distinguishing features are self-evident from the observations quoted above.

F In the result we affirm the decision of the Tribunal and dismiss the appeals. However, we leave it open to the assessee to raise any question as to the computation *i.e.*, the quantum of royalty includible, before the adjudicating authority who has to recompute the turnover in any case consequent upon the Tribunal granting partial relief to the appellant.

G The appeals are dismissed without costs subject to the above observation.

V.S.S.

Appeals dismissed.