IN THE HIGH COURT OF SINDH, KARACHI

Present: Mr. Justice Muhammad Junaid Ghaffar
Mr. Justice Agha Faisal

1.	C.P No. D- 1372 of 2018	M/s. Indus Motor Company Limited Vs. Federation of Pakistan & others.
2.	Spl. Cus. Ref. A. 125/2008	Collector of Customs **VS** M/s. Dewan Farooq Motors Ltd.,
3.	Spl. Cus. Ref. A. 242/2008	The Collector of Customs **VS** M/s. Indus Motor Company Ltd.,
4.	Spl. Cus. Ref. A. 243/2008	The Collector of Customs **VS** M/s. Indus Motor Company Ltd.,
5.	Spl. Cus. Ref. A. 287/2014	Collector of Customs **VS** M/s. Dewan Farooq Motors Ltd. & another
6.	Spl. Cus. Ref. A. 288/2014	Collector of Customs **VS** M/s. Dewan Farooq Motors Ltd. & another
7.	Spl. Cus. Ref. A. 289/2014	Collector of Customs **VS** M/s. Dewan Farooq Motors Ltd. & another
8.	Const. P. 1410/2018	Indus Motors Co. Ltd **VS** Fed. of Pakistan and Others
9.	Const. P. 1665/2020	M/s Indus Motors Co. **VS** Fed. of Pakistan and Others
10.	Const. P. 3593/2021	M/s Indus Motor Co. **VS** Fed. of Pakistan and Others
11.	Const. P. 4807/2021	M/s Indus Motor Co. Ltd **VS** Fed. of Pakistan and Others
12.	Const. P. 4808/2021	M/s Indus Motor Co. Ltd **VS** Fed. of Pakistan and Others
13.	Const. P. 7372/2021	M/s Indus Motor Co. **VS** Fed. of Pakistan and Others
14.	Const. P. 56/2022	M/s Indus Motor Co. Ltd **VS** Fed. of Pakis tan and Others
15.	Const. P. 868/2022	M/s Indus Motor Co. Ltd **VS** Fed. of Pakistan and Others

For the Petitioners: M/s. Rashid Anwar, Aadil Saeed, Advocates.

For the Respondents (in Petitions)**:** Dr. Shah Nawaz Memon, Khalid Rajpar, Sardar Muhammad Ishaque, Muhammad Khalil Dogar, Waqar Ahmed Maitlo, Khalid Mehmood Siddiqui, Muhammad Bilal Bhatti, M/s. Munawwar Ali Memon, Masooda Siraj, Fozia M. Murad, Zuhaib Ahmed, Muhammad Idrees Jakhrani, Bushra Zia for Muhammad Zubair, Pervaiz Ahmed Memon, Syed Mohsin Iman, Touqeer Ahmed Seehar, Hafeezullah, Muhammad Aqeel Qureshi, Jazib Aftab, Shumaila.
Qazi Ayazuddin Qureshi (Assistant Attorney General)
Syed Zain ul Abdin, Deputy Commissioner, SRB.

For the Applicants: (in SCRAs) M/s. Munawwar Ali Memon, Masooda Siraj, Syed Mohsin Imam, Advocates.

For the Respondents (in SCRAs)**:** M/s. Dr. Muhammad Farogh Naseem, Ahmed Hussain, Khalid Jawed Khan, Hanif Faisal Alam, Uzair Qadir Shoro, Umer Akhund, Advocates.

Dates of hearing: **20.02.2023, 06.03.2023, 07.03.2023 & 08.03.2023.**

Date of Judgment: **17.07.2023**

JUDGMENT

Muhammad Junaid Ghaffar, J: In all the listed cases a common legal question[1] is involved; hence, they have been heard together and are being decided through this common judgment. Insofar as Constitution

[1] Whether payment of Technical / Royalty Fee by the Importer to its Supplier was required to be added to the transactional value of imported goods in terms of Section 25(2)(d) & (e) of the Customs Act, 1969

Petitions are concerned they have been filed impugning various show cause notices issued by the Customs department on the ground that the law point already stands decided by the Customs Appellate Tribunal against which SCRA's are pending, and therefore, the exercise carried out by the department is against the law and the judgment of the Tribunal. In all petitions, on this ground department has been restrained from passing any final orders. In fact, the fate of the Special Customs Reference Applications ("**SCRA**") filed by the Department will decide the fate of all petitions filed by the Respondents in these SCRA's. For ease and convenience and with the consent of Counsel for contesting parties SCRA Nos.243 of 2008 was dealt with as the leading case. Following is the detail of the SCRA's and Constitutional petitions along with the details of show cause notice(s); Order(s) in Original and the Order(s) in Appeal.

STATEMENT SHOWING DETAILs OF SCRAs

Sr. No.	SCRA Nos.	Impugned Order	Customs Appeal No.	Show Cause Notice dated	Order-in-Original Dated
1	243/2008 **(Indus Motors)**	09.04.2008	K-512/2006	02.02.2006	02.09.2006
2	242/2008 **(Dewan Farooq)**	09.04.2008	K-80/2006	28.08.2006	18.09.2006
3	125/2008 **(Dewan Farooq)**	09.04.2008	H-161/2008	27.03.2007	12.09.2007
4	287/2014 **(Dewan Farooq)**	10.03.2014	H-707/2009	02.03.2009	19.10.2009
5	288/2014 **(Dewan Farooq)**	10.03.2014	H-706/2009	20.07.2009	19.10.2009
6	289/2014 **(Dewan Farooq)**	10.03.2014	H-156/2008	27.03.2007	07.02.2008

DETAIL(S) OF CONSTITUTIONAL PETITIONS.

Sr. No.	Const. Petition Nos.	Parties names	Date of impugned SCN
1.	C.P No. D- 1372 of	M/s Indus Motor Co. Ltd **VS** FOP	09.02.2018
2.	Const. P. 1410/2018	M/s Indus Motor Co. Ltd **VS** FOP	09.02.2018
3.	Const. P. 1665/2020	M/s Indus Motor Co. Ltd **VS** FOP	02.03.2020
4.	Const. P. 3593/2021	M/s Indus Motor Co. Ltd **VS** FOP	19.05.2021
5.	Const. P. 4807/2021	M/s Indus Motor Co. Ltd **VS** FOP	26.07.2021
6.	Const. P. 4808/2021	M/s Indus Motor Co. Ltd **VS** FOP	26.07.2021
7.	Const. P. 7372/2021	M/s Indus Motor Co. Ltd **VS** FOP	15.12.2021
8.	Const. P. 56/2022	M/s Indus Motor Co. Ltd **VS** FOP	28.12.2021
9.	Const. P. 868/2022	M/s Indus Motor Co. Ltd **VS** FOP	28.12.2021

2. Through SCRA's at Serial No.1 to 3 an identical order dated 9.4.2008 passed separately by the Customs Appellate Tribunal, at Karachi, in 3 different Appeals (K-512 of 2006; K-80 of 2006 and H-161 of 2008) has been impugned by the Applicant Department under Section 196 of the Customs Act, 1969 ("**Act**"). Insofar as the remaining SCRA at Serial Nos. 4 to 6 are concerned, the same have been decided by the Tribunal by following its earlier order dated 9.4.2008, Though various questions of law had been proposed on behalf of the Applicant; however, the same are neither properly drafted, nor are in any manner strictly questions of law, but appears to be argumentative; therefore, they need to be rephrased at the conclusion of this opinion.

3. Mr. Munawar Ali Memon, Applicants Counsel in SCRA No.125 of 2008 (The Collector Customs, Hyderabad v Dewan Farooq Motors Ltd.,) while pressing upon proposed Question Nos.(i)[2] & (iv)[3] has contended that the Tribunal was not justified in passing the impugned order; that the Royalty / Technical Fee has been agreed upon to be paid to the shipper / supplier in terms of Clause(s) 1.4 & 5.2 of the Technical Licence Agreement; ("**TLA**"); hence, the same was required to be added to the Transactional Value of CKD Kits imported by the Respondents in terms of Section 25(2)(d) & (e) of the Act; that the said amount was being admittedly reimbursed to the shipper / franchisor, and therefore, was required to be added to the transactional value of the imported goods in terms of the provision ibid; hence, the impugned order(s) are liable to be set-aside and the proposed questions be answered in favour of the Applicants. He has relied upon judgment of the Customs Tribunal reported in the case of *Honda Atlas Cars (Pakistan) Ltd.*[4] Mrs. Masooda Siraj appearing for the Applicant in one of the SCRA's has referred to Article 16 of the Agreement and has argued that payment / reimbursement of this amount was never disclosed to the department, hence, a show cause notice was issued after conducting post clearance audit; that this amount is to be added to the transactional value of the imported goods of the Applicant. In support she

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2 (i) Whether the learned Appellate Tribunal has erred in law by giving the undue benefit to the party / Appellant (sic) without taking into consideration that the addition of amount of royalties / license fee and technical fee in the value of imported goods is mandatory, in terms of clause (d) and (e) of sub-section 2 of section 25 of the Customs Act, 1969?

3 (iv) Whether the Appellate Tribunal erred in law by ignoring the fact that both the stated forms of Royalty payment, flowing directly from Buyers (Respondents) to the Seller (the Foreign Principals) i.e. 'Technical Fee' (License Fee) and "Running Royalty" under Article 16 of the Technical Assistance Agreement or 'TAA' are ispo facto, liable to be added to the declared transactional value of the said CKD Kits, by way of statutory adjustments, in terms of section 25(2) (d) & (e) of the Customs Act, 1969, and duty / taxes are liable to be paid on such loaded values, accordingly.

4 Honda Atlas Cars (Pakistan) Ltd. Lahore Vs. Collector (Appeals) Customs, Lahore (2012 PTD (Trib) 649)

has also relied upon the case of *Honda Atlas Cars (Supra) and Ghandhara Nisan Ltd.*[5]

4. On the other hand Dr. Farogh Naseem has led the arguments on behalf of Respondent (Indus Motor Company Limited) in SCRA No.243 of 2008 and has contended that in this case a demand was directly raised without a proper show cause notice in violation of judgment in *Khyber Electric Lamps*[6]; that even the show cause notice issued thereafter is vague and unclear as to any allegation against the Respondent, hence it is in violation of the dicta laid down in the case of *Forte Pakistan*[7]*; Exide Pakistan*[8] *& Asia Lubricants*[9]; that even otherwise once the goods were cleared by the Customs Authorities as is the case in hand, it is only the Directorate of Valuation which has jurisdiction to deal with the issue of valuation matters as held in the case of *Pak Suzuki Motors Co. Ltd.*[10]; that the proposed questions otherwise do not arise out of the impugned order, hence, cannot be raised in this Reference Application in view of the dicta laid down in the case of *National Refinery Ltd*[11] *& Urooj (Pvt) Ltd*[12]***;*** that the show cause was even otherwise time barred; that without prejudice, in view of the judgment in the case of *Nestle Pakistan Limited*[13], no recovery of Sales Tax & Income Tax can be made by the Customs Department after clearance of the goods; that no fee or royalty was being paid by the Respondent to its supplier for the goods being valued, therefore, Section 25(2)(d) & (e) are not applicable; that even otherwise the provision in question was made applicable w.e.f. 01.01.2000, whereas, more than 50% of the goods in question were imported between 1997 to 01.01.2000; hence, the said law is not applicable and the value was to be determined under the previous law as was applicable in the relevant period; that neither the amount in question as mentioned in clause 16 of the Technical Agreement is in respect of any royalty or fee; nor it has any nexus with the imported goods, and is only in relation to post importation transactions and therefore cannot be added to the transactional value of the imported goods; that the amount in question has in fact nexus with the deleted parts being procured locally which are manufactured and developed through local vendors and has got no relation with the value of imported goods in

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[5] Ghandhara Nisan ltd. Vs. Collector of Customs (APPG), Karachi and another (2008 PTD 1610)
[6] Assistant Collector Customs & Others Vs. M/s Khyber Electric Lamps and 3 Others (2001 SCMR 838)
[7] (2006 PTD 978)
[8] (2004 P T D 1449)
[9] (2005 PTD 950)
[10] (2006 P T D 2237)
[11] (2003 P T D 2020)
[12] (2004 PD 295)
[13] 2023 PTD 527

question; that in terms of section 25 ibid it must be a pre-condition of sale and only then it can be added to the transactional value; lastly by placing reliance on the cited law[14] he has prayed for dismissal of the Reference Application. All other Counsel appearing for respective Respondents in SCRA's have adopted the legal submissions made by Dr. Farogh Naseem. Mr. Rashid Anwar, learned Counsel for the Petitioners in addition to adopting the legal submissions of Dr. Farogh Naseem, has further argued that the payment in question in respect of royalty has no nexus with the imported goods; hence it cannot be added to the value of goods being imported, whereas, direct Petitions against show cause notice(s) are competent as after Tribunals favorable order, there was no occasion for the department to issue fresh show cause notices to the petitioner in respect of subsequent imports as the matter stands decided against them. He has therefore, prayed that all notices be quashed / set-aside.

5. We have heard all the learned Counsel and perused the record. It appears that the Respondent (Indus Motor Company Limited) in SCRA No. 243 of 2008 is an authorized agent and manufacturer of Toyota vehicles in Pakistan having a Technical Assistance Agreement since 1991 with its principal i.e. Toyota Tsusho Corporation, Japan and for such purposes, regularly imports CKD (Complete Knock Down) Kits of various models of Toyota Vehicles. It is a matter of admitted position that all the consignments in question (though not detailed in the demand notice) were released by the Applicant Department by accepting the Transaction Values under Section 25(1) of the Customs Act, 1969 ("**Act**") without raising any objection. Record further reflects that on 2.2.2006 a Demand Notice was issued to the Respondent under Section 32(3) of the Act in respect of its past clearance of CKD Kits for the period starting from 1997 to November, 2005 and it was alleged that a total of Rs. 370.373 million is to be recovered on the ground that the Royalty payment of 3% pursuant to Clause 16 of the Agreement with M/s Toyota Corporation Japan read with

[14] Amtex Limited Vs. Customs Excise and Sales Tax Appellate Tribunal (2011 PTD 602), Al-Tech Engineers and Manufacturers Vs. Federation of Pakistan and others (2017 SCMR 673), Messrs Clariant Pakistan Limited Vs. Collector of Customs (Appeals), Karachi and another (2004 P T D (Trib) 2712), M/s. Honda Atlas Cars (Pakistan) Ltd. Lahore and others Vs. Collector (Appeals) Customs, Federal Excise & Sales Tax, Lahore and others (2012 PTD (Trib) 649), Honda Atlas Cars Pakistan Limited Vs. Appellate Tribunal and 2 others (2021 PTD 1947), Collector of Customs, Bombay Vs. M/s. Maruti Udyog Ltd., Gurgaon (1989 (22) ECR 482 (S.C.), Commissioner of Customs, New Delhi Vs. Prodelin India (P) Ltd. (2006) 10 SCCR 280, Commissioner of Customs (Port), Kolkata Vs. J. K. Corporation Limited (2007) 9 SCC 401, Commnr. Of Customs (Port), Chennai Vs. Toyota Kirloskar Motor Pvt. Ltd. (2007) 5 SCC 371, Commissioner of Customs Vs. Ferodo India Pvt. Ltd. (2008) 4 SCC 563, WEP Peripherals Ltd. Vs. Commissioner of Customs, Chennai (2008) 4 SCC 561, Indusind Media & Communications Ltd. Vs. Commissioner of Customs, New Dehli (AIR 2019 SC 4812), Commissioner For The South African Revenue Service Vs. Delta Motor Corporation (Pvt) Ltd. (2002) ZASCA 114

Section 25(2)(d) & (e) of the Act, the transactional value was required to be enhanced and or added with this payment of Royalty, and as a consequence thereof, extra customs duty and taxes were to be paid. The Respondent replied to the said Notice and contested the same on various legal grounds; however, on 2.9.2006 an Order in Original was passed by the Collector of Customs, whereas, all the legal objections of the Respondent were dismissed and the amount mentioned in the Demand Notice was adjudicated and enforced. The Respondent being aggrieved preferred Appeal under Section 194-A of the Act and the Customs Excise & Sales Tax Appellate Tribunal Bench-I at Karachi has decided the Appeal of the Respondent along with two other Appeals of similarly placed importers cum manufacturers and has allowed the Appeals by setting aside the impugned orders.

6. Insofar as the issue in hand is concerned, there is only one legal question involved; i.e. whether the payment of Royalty pursuant to Clause 16 of the Technical Agreement is to be included in the value of the imported CKD Kits pursuant to Section 25(2)(d) & (e)[15] of the Act. The learned Tribunal has been pleased to hold that it is not to be added. The question before this Court is the correct interpretation of Section 25(2)(d) & (e) of the Act read with Article 16[16] of the Agreement in question. It need not be reiterated that w.e.f. 01.01.2000 Section 25 of the Act has done away with the old concept of notional / normal value or the Brussels Definition of value (BDV)[17] of goods and has adopted the concept of transactional value based entirely on General Agreement on Trade &

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15 (2) Subject to clause (b), in determining the customs value under sub-section (1), -

(a) ……………..
(b) ……………..
(c) ……………..
(d) there shall also be added to such price, royalties and license fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable; and
(e) there shall also be added to such price, the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller;

16 **Article 16. Technical Know-How Fee and Royalty**

(a) In consideration of license to use technical information, know-how and data furnished by the Licensor under Article 3 hereon, the Licensee shall pay Running Royalty as described in paragraph (b) hereof and Technical Fee in four (4) installments as follows (collectively hereinafter referred to as "royalty payments"):
(b) The Running Royalty on each of the Licensed Products manufactured by the Licensee shall be paid at three percent (3%) of C & F value of deleted parts and components commencing only after Twenty-one percent (21%) deletion has been achieved in each of Corolla, HiLux, Hiace Van and Land Cruiser, respectively. For this purpose, the number of the Licensed Vehicles subject to Running Royalty shall be determined at the time of their sales by the licensee to the customers.
(c) ……...
(d) In the event that the Licensee has sold the Local Parts as spare parts for the Licensed Vehicles or other Toyota Vehicles during any calendar year, the Licensee shall pay the Licensor Running Royalty on all of such Local Parts at the rate of three percent (3%) of the Licensee's total wholesale prices during such calendar year. However, such Local Parts as listed in Appendix B attached hereto shall not be subject to the Running Royalty.
(e) ……...
(f) ……...

17 i.e. the notional concept of value: *that is, goods should be valued at the price at which such goods would sell* in the open market independent of the buyer and the seller

Tariff (GATT) envisaged in the World Trade Organization's Valuation Agreement concluded in the year 1995 and signed by more than 140 Countries including Pakistan. After the expiry of the grace period provided to Pakistan being a developing country pursuant to Article 20.1 of the WTO Agreement read with WTO first annual review dated 13.10.1995 for transformation to the new system, it is now effective from 01.01.2000 in Pakistan. The idea of change in the concept of Valuation of Imported Goods was an outcome of long deliberations and after successive meetings and conferences of around 124 Governments as well as the European Community participating in Uruguay Round of Multilateral Trade negotiations held in 1994, resulting in the establishment of World Trade Organization (WTO) in Geneva on 01.01.1995 and after abolition of GATT and formation of WTO for regulating International Trade, the entire GATT Code of Valuation has been incorporated as Article VII of WTO Agreement. For a better understanding, it may further be explained that Transactional Value system has in itself 6 methods of Valuation of Imported Goods which per law are to be applied in a sequential manner (except that the Importer may request that the order in which Deductive Method and Computed Method are to be applied, be Reversed-See S.25(10)). Under the Act, Section 25(1) to (4) describes and defines the Transaction Value of the Imported Goods and how it has to be determined. Sub-section (5) deals with Transaction Value of Identical Goods; Sub-section (6) deals with Transaction Value of Similar Goods; Sub-section (7) deals with Deductive Value method; Sub-section (8) provides how the Computed Value method is to be applied; and lastly Sub-section (9) explains the Fall Back or Reasonable Means Method. It may also be of relevance to note that Article 8 (1) (c) of the WTO Valuation Agreement deals with the situation in hand corresponding to Section 25(2)(d) & (e) of the Act. It states that in determining the Customs value under the provisions of Article 1 (Transactional Value); there shall be added to the price actually paid or payable for the imported goods; *(i)* royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable; and [Article 8 (1) (d)] *(ii)* the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller. These two have been further explained in the Notes to Article 8 in Paragraph 1(c) and states that the royalties and licence fees referred to in paragraph 1 (c) of Article 8 may include, among other things, payments in respect to patents, trademarks and copyrights.

However, the charges for the right to reproduce the imported goods in the country of importation shall not be added to the price actually paid or payable for the imported goods in determining the Customs value. As to Article 8(1) (d) it is provided that payments made by the buyer for the right to distribute or resell the imported goods shall not be added to the price actually paid or payable for the imported goods if such payments are not a condition of the sale for export to the country of importation of the imported goods.

7. For the present purposes it is only s.25(2)(d) & (e) which is to be looked into and interpreted. Section 25(2)(d) provides that while accepting transactional value of the goods under sub-section (1) of s.25, there shall be added to such price, the *royalty and license fees* relating to the *goods being valued* that the buyer must pay either directly or indirectly, as a *condition of sale of the goods being valued* to the extent that such royalty fees are not already included in the price actually paid or payable. Similarly, sub-section (e) of Section 25(2) ibid further provides, that there shall also be added to such price the value of any part of the proceeds of any *subsequent resale, disposal or use of the imported goods* that accrues directly or indirectly to the seller. Before proceeding further, it needs to be clarified that S.25(2) (d) and (e) of the Act altogether speak about different situation(s) and payments being made or accrued to the Supplier or Shipper. S.25(2) (d) refers to Royalty payments, whereas, S.25(2) (e) refers to *subsequent proceeds*. In our considered view, they cannot be invoked or applied simultaneously at one point of time as done in the demand notice of the Applicant. Both deal with different additions of value, if any, and from the given facts we are unable to discern as to how the Applicant Department, while issuing the demand notice and passing the Order in Original has invoked and pressed upon both these sub-sections / provisions together. Neither s.25(2) (e) of the Act; nor Article 8 and its Interpretative Notes to WTO Valuation Agreement provides any assistance as to under what situation the *subsequent proceeds* have to be included in the value of imported goods. For the present purposes, it could be safely held that the Applicant department was by itself unclear as to invoking both these provisions as apparently their case is premised on payments of *Royalty* as per their own demand notice on the basis of Article 16 of the Agreement between the Respondent and their Supplier. Therefore, insofar as S.25(2)(e) of the Act and its implication is concerned, no further discussion ought to be made, and be left to be taken up in an appropriate case having facts germane to the invocation of the said

provision. However, as to the applicability of Section 25(2)(e) of the Act to the case of Respondent(s) in hand is concerned, it apparently has no nexus with clause(s) in their respective agreements as it does not provide for any payment of proceeds to the principal in respect of any subsequent resale, disposal or use of the imported goods in question. As noted earlier it is confined to the technical assistance in respect of the deleted parts and not otherwise.

8. Now we will advert to the implication of S.25(2)(d) of the Act insofar as Clause 16 of the Agreement in question is concerned. It relates to Technical Know-How Fee and Royalty and states that in consideration of the license used in technical information, know-how and data furnished by the Licensor under Article 3 hereof, the licensee shall pay Running Royalty as described in Paragraph (b) and technical fee in four installments. Sub-Clauses of Article 16(a)(i)(ii)(iii) and (iv) thereof provides further details of the vehicles and the amount so payable. Similarly, Article 16 (b) further provides that the Running Royalty has to be paid on 3% of C & F Value of the <u>*deleted parts and components*</u> commencing only after 21% of deletion has been achieved in each of the vehicle in question. We may add that in many Developing countries like Pakistan, the Government sets a level for the local auto assembler to achieve for indigenization so as to promote the local industry, and all such parts as are locally available are recognized as *deleted parts* of a complete CKD unit which are not imported from abroad. Moreover, their quantum or percentile has to increase gradually on a yearly basis as per the Policy. In Pakistan, such policy at the relevant time was being enforced through Engineering Development Board which required all such Manufacturers to maintain a deletion program. As noted earlier, while invoking the Section 25(2)(d) there are two conditions which must be fulfilled before the said sub-section can be invoked; (i) such royalty which is being paid must relate to the ***goods being valued***; and (ii) shall be a ***condition of sale of the goods being valued*** and such royalty must not have already been included in the price actually paid or payable. When clause 16 of the Technical Agreement is read with the aforesaid provisions of the Act, it appears that it has no nexus with the goods being valued at the import stage. The royalty refers to the ***deleted parts*** which means that when CKD Kit is being imported, it will not include value of the parts which are to be procured and manufactured locally; hence, it is not related to or has any nexus with the goods being valued which is a precondition for invoking the provision of s.25(2)(d) while making additions in the transactional value of

imported goods. The royalty in question is being paid in respect of the deleted parts; hence, it has no nexus with the goods being valued. It is in fact a royalty for providing technical assistance by the Toyota Motor Corporation to the Respondent herein in respect of achieving the deletion as required under the Automobile Manufacturing Policy of the Government which has to be progressively increased as more and more local parts are to be added to the CKD Kits. The royalty, if any, is being paid for such technical assistance which is required for manufacture and procuring the deleted parts; hence, it has no nexus with the goods being valued. Such payment for technical assistance cannot be attributed to the price of the goods being valued merely for the reason that it is compensating the Supplier on account of more and more indigenization leading to decreased imports of complete CKD Kits. Therefore, insofar as Section 25(2)(d) of the Act is concerned, it has no nexus or relevance at least when clause 16 of the Technical Agreement in question is looked into. The entire case of the Applicant Department is confined to the relevance and applicability of clause 16 of the Technical Agreement as per the demand notice in question, which in our considered view does not appear to have any relation to the goods being valued by the Applicant department; hence, the same cannot be added to the value for the purposes of levying customs duty and taxes. Reference may also be made to Rule 122(7) of the Customs Rules, 2001, which provides that an addition to the price actually paid or payable in respect of Royalty can only be added if it is based only on the imported goods and can be readily quantified.

9. On our own, a detailed reading of the relevant provision under discussion from The Customs Act,1969, by Javaid Umar (now late), which perhaps is the most authentic and deeply researched Book ever on the Customs Laws in Pakistan, it reflects that The Controller Valuation, Customs, Karachi, on 22.8.2003 (See Para 48.8 at pg:422 of the Book) had written a letter to Technical Committee on Customs Valuation, Brussels, Belgium, seeking guidance on levying duties on such payment of Royalty under Article 8.1(c) of the Valuation Agreement. Though names of the parties were not disclosed in such correspondence; but the contents thereof, suggest that it was in respect of one of the Respondents before us. Whether such query was responded by them or not is unclear; however, when the said query is deeply looked into, it transpires that the then Controller Valuation was of the view that this amount of Royalty is not to be added to the Customs Value of imported Goods. Following observations in the said letter / query are relevant;

> The question that arises whether the royalty payment constitutes an addition to the price actually paid or payable under the provisions of Article 8.1 (c) which states that "Royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly as a condition of sale of the goods being valued to the extent that such royalties and fees are not included in the price actually paid or payable. *At first glance, the answer would seem obvious. The royalty does not constitute an addition because it is assessed against goods manufactured in Pakistan and as such the royalty payment is neither related to the goods being valued nor is it a condition of their sale. Indeed, since the goods are manufactured in Pakistan, there is no importation and there is no application of customs laws and regulations.*
>
> Nevertheless, this administration is perplexed by this arrangement as it would appear that the beneficiary of the right to produce and sell the parts (the domestic manufacturer) is not required to pay for that right, rather it is his customer that is obligated to pay [or the privilege of buying goods from an unrelated supplier. Additionally, the benefit of the payment does not accrue to the seller but to a third party who, at least, on the surface, has little to do with the transaction between the buyer and the seller. Furthermore, the calculation of the payment does not appear to be based on any actual transactions. Rather, it appears to be calculated on "opportunity lost" by "Y" for that portion of the value of a complete Kit that "Y" did not directly supply and which was not imported. As was previously noted, it is interesting that "X" does not pay anything beyond the invoice price to "Y" for the 60% of the Kit which is imported but is only required to make an additional payment over the price of the goods for the 40% of the vehicle which is locally supplied even though both portions combined represent a single item.
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> It might be argued that "Y" suffers an economic loss under Pakistan's "deletion programme" in as much as without it, "Y" would supply the vehicle fully either as a finished product or as a 100% CKD Kit and thereby earn profit on the total vehicle. *The deletion programme, in a sense, deprives profit earnings from "Y" on 40% of the vehicle, which "Y" does not supply directly. If this is the case, one way to recoup the profit loss would be to charge a "royalty payment" to the manufacturer or, in the case of a related party user, to that user. This could be one explanation as to why there is a "running royalty" on the locally supplied parts but none on the imported parts of what is essentially a single item.*
>
> This scenario raises, in Pakistan's view, at least two questions that this administration believes are fundamentally important. The first is that while the payment is characterized as a "royalty payment" by the agreement between "X" and "Y" is it in fact such a payment? Secondly, if the payment is not a royalty payment, is it, in fact. Simply part of the price actually paid or payable for the 60% of the CKD Kit which is imported and that is paid to "Y" by "X" so that "Y" can earn its full expected profit on each Kit. In other words, is it the case that "Y" has simply increased the cost of the imported portion of the Kit using this technique, to recoup the profit to L would have been earned by "Y" if the complete kit would have been imported?

10. We are at a loss to understand that if the Controller Valuation, Customs, Karachi was of the above opinion, then as to why these proceedings have been initiated by the department, as the contents of the above query fully support the case of the present Respondents. Even if no response or decision was received from WCO, the course of action adopted ought to have been fully based on the above interpretation of the Valuation Department, which is fully empowered and has jurisdiction in the matter. However, the demand notices reflect that the same has been issued on the basis of some decision taken by FBR and concurred subsequently by the Controller of Customs Valuation somewhere in 2005; but this course of action does not seem to be based on a proper understanding of law; hence, cannot be accepted.

11. It may also be of relevance to observe that despite our best efforts as well as that of the Respondents Counsel we have not been able to lay

our hands on any binding precedent of our Courts as to the subject controversy; barring a few from the Tribunal itself. However, this issue has been put to rest by the High Court(s) as well the Supreme Court of India in a number of cases. Since the provisions of law are based on an International Convention so adopted by the member countries and are also parimateria[18]; we would like to discuss and rely upon such precedents. The learned Bombay High Court in the case of *Mahindra*[19] was seized with an Appeal against an order of a single judge in writ jurisdiction, whereby, he was pleased to hold that there was no nexus between the royalty being paid by Mahindra to its supplier Peugeot as to the goods being valued. In that case Mahindra imported CKD packs and components from Peugeot and Customs Appraising Group referred the question as to the valuation of a consignment of crankshafts imported to the Special Valuation Branch of the Customs Department. The Assistant Collector of Customs, Special Valuation Branch, served notice on Mahindra communicating the tentative decision taken for loading the invoice price mentioned in respect of the imported goods on the ground that payment as lump sum amount of 15 Million French Francs amounting to Rs. 3 Crores approximately is considerably large amount and the agreement provides for facilities not only of technical know-how but also the right to use designs, patents and trademarks which are properties of the collaborators. He went on to observe that circumstances under which CKD packs are imported warrant the application of valuation under Rule 8 read with Section 14(1)(b) of the Customs Act before assessment and tentatively he has decided to load the invoice of CKD components at the rate of 2.5%; 1.5% on account of patent, trademarks and designs, and 1% on account of royalty. An order was passed against which Appeal also failed and thereafter the Company succeeded in its petition before a Single Judge which was also maintained in Appeal. The learned Division Bench upheld the said decision and was pleased to hold as under;

> 13…….We, therefore, find considerable merit in the submission of Shri Setalvad that there is no relationship whatsoever between the payment of lump sum of 15 Million French Francs and settlement of price by negotiations between the parties for supply of CKD packs. We are in agreement with conclusion of the learned Single Judge that Article 'F' of the Collaboration agreement dealing with supply of CKD packs and the determination of price thereof is de hors independent of the consideration of 15 Million French Francs paid by Mahindra to foreign collaborators for supply of technical know-how. <u>In our judgment, there is nothing in the collaboration agreement to suggest that the price of CKD packs was to be determined by the parties by taking into consideration the amount of 15 Million French Francs paid under the collaboration agreement</u>. As mentioned here in

[18] See Section 14 of the Customs Act, 1962 read with Rule 9(1) (c) & (d) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988

[19] 1991 (55) ELT 15(Bom.)

> above, the price of CKD packs was to be quoted by the foreign collaborator and Mahindra was not bound to accept the price and purchase the CKD packs unless the price was found to be acceptable. There was no compulsion on the Mahindra to purchase CKD packs or any components thereof. The collaboration agreement leaves it to the discretion of Mahindra to accept the prices quoted by foreign collaborator for supply of CKD packs and components. The agreement also reflects that the prices were not static but were liable to be revised from time to time during the subsistence of agreement and price of CKD packs and components had no relation to the payment of 15 Million French Francs paid by Mahindra. <u>The contention of Shri Bhabha that the price quoted in the invoices tendered by Mahindra does not reflect the correct price because a part of the value of the imported packs and components was already recovered by foreign collaborator while determining the consideration of 15 Million French Francs cannot be accepted. In our judgment, the collaboration agreement does not support the claim, nor there was any material available to the Assistant Collector to warrant such conclusion.</u>

12. This judgement was though challenged by the Customs Department before the Indian Supreme Court through *<u>Union of India</u>*[20] but was maintained by the Supreme Court in the following terms.

> 8. On an evaluation of the relevant clauses in the collaboration agreements and the attendant circumstances, we are of the view that the concurrent Judgments of the High Court at Bombay do not merit interference in this appeal. The crucial aspects appearing in the case are that the parties were dealing at arm's length, that the seller and the buyer have no interest in the business of each other, that, ordinarily, the technical know-how of the machine can take in 'the assembly thereof, that the CKD packs and spares were supplied to the respondents by the collaborator not at a concessional price but at the price at which they were sold to others, that, as agreed to by the respondents, the option was entirely with the respondents to order the parts as per their requirements, that there was no obligation on the respondents 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 is 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 but, on the other hand, the collaboration agreement for the technical know-how and the supply of CKD packs and spares are independent commercial transaction; in other words, there existed no nexus between the lumpsum payment under the agreement for the technical know-how and the determination of the price for supply of CKD packs or spares. It is by highlighting the above aspects that the learned Single Judge and the Division Bench concluded that "the contention that the price quoted in the invoices tendered by Mahindra & Mahindra (respondents) does not reflect the correct price because a part of the value of imported packs and components was already received by foreign collaborator while determining the consideration of 15 million French Francs cannot be accepted", and "the collaboration agreement does not support the claim nor was there any material available to the Assistant Collector to warrant such a conclusion", and, therefore, resort to Section 14(1)(b) of the Act and Rule 8 of the Customs Valuation Rules is clearly incorrect and unsustainable and the "Assistant Collector was bound to accept the price mentioned in the invoices for the purpose of assessing the customs duty".
>
> 9. We are of the view that the reasoning and conclusion of the learned judges of the High Court are justified and valid in the facts and circumstances of the case. The collaboration agreement entered into between the parties is clear and it is not open to the revenue to construe it differently by reading into it

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20 1995 (76) ELT 481 (S.C.)

> something which is not there. In the result, we hold that the Judgment appealed against does not merit interference and this appeal deserves to be and is hereby dismissed with costs, which we quantify at Rs.10,000

13. In the case of *Maruti Udyog Limited*[21], (upheld by the Indian Supreme Court in *Collector of Customs, Bombay*[22]) the Appellate Tribunal (Delhi Bench) in somewhat similar facts dealt with the case of Maruti Udyog Limited, who is the manufacturer of Suzuki Maruti cars in India. The royalty was being paid by Maruti to its supplier and Collector of Customs had added such royalty to the value of CKD Kits Imported by them. Maruti's case was that the royalty payments were only for local manufacture of vehicles and parts under the indigenization program and had nothing to do with the price of the imported SKD/CKD packs and complete vehicles. The Tribunal held in favor of Maruti in the following terms;

> 5. The department next contended that the invoice price of the imported goods was not the only consideration for the sale and that the other consideration which flowed from Maruti to Suzuki was the payment of lump sum royalty and running royalty. The learned representative of the department stated that though ostensibly the royalties related to manufacture in India of Suzuki's components, it could be an inducement for depressing the import price. Even if this was not so, the learned representative of the department continued, the expectation of a future pecuniary advantage to Suzuki under their long term tie-up with Maruti was certainly there. He further stated that under Article 5.02 of the Licence Agreement, Maruti acquired the right to use the allied trade mark "MARUTI-SUZUKI". The agreement did not indicate any fee for use of this trade mark but some consideration to use the trade mark had to be there. *Here too, we find substance in the argument of Maruti that payment of royalty/fee under the Licence Agreement was relatable directly to indigenous manufacture of components and vehicles to Suzuki's patents, designs and specifications. Similarly, use of the trade mark "MARUTI-SUZUKI" was also for marketing of the indigenously manufactured goods in India. Neither the royalty nor the trade mark "MARUTI-SUZUKI" had anything to do with import of components, assemblies and vehicles from Japan. One can understand the logic behind payment of royalty. When Suzuki transferred the technical knowhow and permitted Maruti to use its patents and designs, Suzuki had naturally expected to be compensated for it. When the indigenization program of Maruti progressed, import of components from Suzuki would gradually go on decreasing. That would reduce Suzuki's profits which it would have earned in exporting components from Japan to Maruti. Naturally, Suzuki would expect to be compensated on that count also. These compensations, after negotiation between the two parties, resulted in the clause relating to payment of royalty under the Licence Agreement. But the essential point is that these payments were relatable directly to manufacture of goods in India and they had no nexus with import of goods from Japan, it is, therefore, not correct to load the import price on account of payment of royalties for local manufacture. No evidence has been laid before us*

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21 1987 (28) ELT 390 (Tri.Delhi)
22 1989 (22) WCR 482 (SC)

> *to show that payment of royalty induced any extra -commercial reduction in the import price. Since the technical tie-up between Maruti and Suzuki is a long term one, future pecuniary advantage to both parties would certainly be a natural expectation. Without such expectation, no commercial dealings are possible. As indigenization program progresses, the payment of royalty would also increase but Suzuki's profit in export will decrease correspondingly. The department's argument that import invoice price was not the sole consideration for sale of the imported goods, therefore, does not impress us.*

14. In the case of ***Prodelin India (Private) Limited***[23] the Indian Supreme Court while dealing with similar facts has been pleased to hold that it was completely wrong on the part of the department to add any or all payments of technical service fee or any other amount (royalty) paid to the Joint Venture Partner which relates to any post importation activity and understanding as it has no nexus with the imported goods which are to be valued on the basis of their transactional value independently. It was further held that when such payment was for post importation activity, it was obligatory on the part of the department to first controvert the same and in absence of anything on record contrary to such facts, it was not open for them to add the said payments to the value of the goods being assessed by them as it has no relation or nexus with it. Similar view has been expressed once again by the Indian Supreme Court in the case of *J. K Corporation Limited*[24]; by holding that any amount paid for post-importation service or activity would not come within the purview of determination of assessable value of the imported goods so as to enable the customs to levy any customs duty on it. In the case of *Toyota Kirloskar Motor (Private) Limited*[25], it has been held by the Indian Supreme Court that the transactional value must be relatable to import of goods which a fortiori would mean that the amounts must be payable as a condition of import, and a distinction therefore, clearly exists between an amount payable as a condition of import and an amount payable in respect of the matters governing manufacturing activities, which may not have anything to do with the import of goods. In the case of *Ferodo India (Private) Limited*[26], once again it has been reiterated by the Indian Supreme Court that if the consideration clause (of the Agreement) indicates that the importer / buyer had adjusted the price of the imported goods in guise of enhanced royalty or if the Department finds that the buyer had misled the Department by such pricing adjustments then the Adjudicating Authority would be justified in adding the royalty / licence fee payments to the price of the imported goods. This exercise is completely missing in the instant

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[23] (2006) 10 SCC 280
[24] (2007) 9 SCC 401
[25] (2007) 5 SCC 371
[26] (2008) 4 SCC 563

matter and nowhere it has been established by the department that the Respondent herein had indulged into any such practice or attempt; and therefore, the ratio of this case is fully attracted to the case of the present Respondent before us. Lastly, there is another interesting case from the South African jurisdiction wherein, the Supreme Court of Appeal of South Africa in the case of *Delta Motor Corporation (Pty) Limited*[27], has been pleased to dismiss an Appeal by the Revenue department against an order of the High Court whereby, Delta's application for refund of excess customs duty paid on the amount of Royalty was ordered to be refunded. It was the case of Delta that year after year due to an inadvertence and lack for full facts they had been paying customs duties on the amount of EST (engineering, styling and tooling) charges paid to M/s OPEL, Germany, which had though no nexus with the value of the Imported goods. The Supreme Court of South Africa agreed; and held that EST charges are paid in respect of assembled vehicles sold and not in respect of imported kits; and therefore, these charges are not dutiable.

15. Besides the above legal question in respect of the very merits of the case, there are two other legal issues, which also rise from the order of the Tribunal. The first issue, which was also raised by the Respondent before the Tribunal was in respect of the Demand Notices, being time barred and so also that the imports pertaining to the period starting from 1997 till 31.12.1999 are to be governed by the old law; hence the amended Section 25 of the Act could not be applied. Similarly, another issue, which was also raised by them was in respect of the alleged recovery of Sales Tax and Income Tax by the Customs Authorities after clearance and out of charge of goods in terms of Section 32(3) of the Act as according to them pursuant to Section 6 of the Sales Tax Act, 1990, the short recovery, if any, of sales tax in question can be made under Section 36 of the Sales Tax Act, 1990 and not under Section 32(3) of the Act. Both these issues have though been raised before the Tribunal; however, the Tribunal has not given any finding on these questions; hence, in view *Commissioner of Income Tax v National Refinery Limited*[28], they do arise out of the order of the Tribunal; however, the Respondent before us has not impugned the order of the Tribunal. Therefore, these questions cannot be looked into and decided by this Court. However, we may observe that there appears to be great force in these submissions as apparently the law in question i.e. Section 25 in its present form has been made

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[27] MANU/SASC/0015/2002 or (2002) ZASCA 114
[28] CIT v National Refinery Limited (2003 PTD 2020). Also see CIT v. Gohar Ayyub Khan (1995 PTD 1074) & Iram Ghee Mills (Pvt.) Ltd. Lahore v. Income Tax Appellate Tribunal, Lahore (1998 PTD 3835)

applicable w.e.f. 01.01.2000 pursuant to SRO 1375(I)/1999 dated 28.12.1999. Secondly, the Demand Notices have been issued in the year 2006 pertaining to the imports starting from 1997, and therefore, apparently up to 2003, they appear to be hopelessly time barred. Thirdly, the issue regarding the authority and jurisdiction of the Customs to recover the sales tax and income tax after clearance of the consignments has also been decided by this Division Bench in the case of ***Nestle Pakistan Limited***[29]***.*** by holding that Customs do not have such jurisdiction.

16. Insofar as Respondent in remaining SCRA's is concerned, their Agreement has not been discussed or interpreted by the Tribunal in the impugned order. It has only referred to Article 16 of the Agreement of Respondent in SCRA 243 of 2008. Since we have already dealt with the legal issue and for the reason that these matters are pending since 2008 onwards, we find it extremely unfair to remand the matter to the Tribunal and have taken it upon ourselves to examine the Agreement of this Respondent. On perusal of their Agreement it appears that though it is materially different, from the Agreement of Respondent in SCRA No. 243 of 2008; however, when clauses 1.3; 1.4; 3.1.3; 3.4; 5.1 & 5.2[30] are looked into, it clearly reflects that payment of such royalty and technical know-how fee has no nexus with the Imported goods nor it is a condition of sale of such goods; hence, cannot be added as part of the value of the goods in terms of S.25(2)(d) of the Act; hence, not liable for payment of any customs duty on it.

17. The upshot of the above discussion is that based on the expression(s) employed in the Agreement(s) in question; neither it is established that the *royalty and license fees* in question relates to the *goods being valued* notwithstanding that it is being paid to the buyer either

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29 2023 PTD 527

30 1.3 Locally sourced parts shall mean component parts, replacement parts and/or accessories, as from time to time agreed by the parties hereto, of Licensed Products, which shall be manufactured in the Territory by or for LICENSEE for the manufacture of Licensed Products in the Territory in accordance with drawing, specifications and other information furnished to LICENSEE under this Agreement.

1.4 "Knock down assembly operation" shall mean assembly of one unit of KD pack alongwith locally sourced parts as to make one unit of complete finished Licensed Product.
3.1.3: LICENSOR agrees, upon request in writing, to sell to LICENSEE such machinery, tools, and equipment, including, but not by way of limitation, jigs, fitting tools, tool gauges, patterns, dies, appliances and other necessary items for the manufacture/assembly of Licensed Product at prices, terms and conditions to be mutually agreed upon by the parties hereto.
3.4: Licensor confirms that it is fully aware of the requirement of the Government of Pakistan about achievements of maximum deletions (i.e. localization plan / progressive manufacturing of the components) within the shortest possible period and agrees to fully assist Licensee in achieving the deletion program for the Licensed Products as set out by the Government of Pakistan in the Industry Specific Deletion Programme, as issued from time to time by the Engineering Development Board, Government of Pakistan.
5.2 Engineering fees of Sixty Dollars (US$ 60.00) shall be paid by LICENSEE with respect to each and every Licensed Vehicle sold by LICENSEE during the continuance of this Agreement (including all permitted derivatives thereof made by LICENSEE).

directly or indirectly; nor it is a *condition of sale of the goods being valued* and therefore, it can be safely held that the Royalty / Fee in question is not liable to be added to the Customs Value being determined in terms of Section 25(1) of the Act read with S.25(d) & (e) ibid and therefore the only question of law (rephrased by us) i.e. *"Whether in the facts and circumstances of the case, the Tribunal was justified in holding that the payment of Technical Fee / Royalty Fee in terms of the Agreement(s) in question was not required to be added to the declared transactional value as provided in Section 25(2)(d) & (e) of the Customs Act, 1969"* is answered in the affirmative; against the Applicant department and in favour of the Respondents. As a consequence, thereof all SCRA's stands dismissed.

18. Lastly as to maintainability of connected petitions wherein show cause notices have been directly impugned before this Court, we are satisfied that the petitions are maintainable in the circumstances of the present case. As correctly contended by learned Counsel for the petitioners, the impugned show cause notices for subsequent imports are based squarely on the same issue which is now before us by way of SCRA's against the Tribunal's order which is in their favor, whereas, the Department still intends to pass similar Order(s), disregarding the Tribunal's order in question. In our considered view, resort to statutory remedies below the Tribunal level would therefore be a mere formality. Furthermore, the Tribunal's order is itself before this Court in SCRA and not stand decided. In these circumstances, the petitions cannot, and ought not, to be dismissed as not maintainable[31].

19. Accordingly, all Reference Applications are ***dismissed***, and as consequence thereof, the Petitions are ***allowed*** to the extent that notices impugned or pertinent constituents thereof are hereby quashed / set-aside. Let copy of this order be sent to Customs Appellate Tribunal, Karachi, in terms of sub-section (5) of Section 196 of Customs Act, 1969. Office to place copy of this order in the connected Reference Applications as above.

Dated: **17.07.2023**

J U D G E

J U D G E

[31] Engro Vopak Terminal Ltd vs. Pakistan (2012 PTD 130) & Dr. Zafar Sajjad v CIR (2022 PTD 109)

Ayaz