BEFORE THE DIVISION BENCH-I, ODISHA SALES TAX TRIBUNAL: CUTTACK

S.A. No. 94 (VAT) of 2018

(Arising out of order of the learned Addl.CST (Appeal), North Zone, Sambalpur in Appeal No. AA- 08 (V)/ACST(Asst) SBPR/07-08, disposed of on dated 30.01.2018)

Present: **Shri A.K. Das, Chairman**
&
Shri S. Mishra, Accounts Member-II

State of Odisha, represented by the Commissioner of Sales Tax, Odisha, Cuttack ... Appellant

-Versus-

M/s. ACC Ltd.,
Bargarh Cement Works,
Cement Nagar, Bardol, Dist. Bargarh ... Respondent

For the Appellant : Sri D. Behura, S.C. (CT) &
Sri S.K. Pradhan, Addl.SC (CT)
For the Respondent : Sri S. Ray, Advocate

Date of hearing: 25.05.2022 *** Date of order: 04.06.2022

O R D E R

The State has preferred this second appeal questioning the legality and propriety of the order dated 30.01.2018 passed by the learned Addl. Commissioner of Sales Tax (Appeal), North Zone, Sambalpur (hereinafter called as 'first appellate authority') in Appeal No. AA- 08 (V)/ACST(Asst) SBPR/07-08 thereby allowing the appeal in part and reducing the demand to ₹8,01,282.00 from

₹1,05,87,983.00 raised by the Asst. Commissioner of Sales Tax, Sambalpur Range, Sambalpur (in short, 'assessing authority') for the tax period 01.04.2005 to 30.09.2006 in the assessment framed u/s. 42 of the Odisha Value Added Tax Act, 2004 (in short, 'OVAT Act').

2. The relevant facts leading to filing of the present second appeal are that the dealer-assessee runs a manufacturing unit for manufacture of cement, which it sells both outside and inside the State and despatches cement to outside the State by way branch transfer. The dealer receives lime stone from its own quarry and purchases slag, gypsum, iron ore fines, fly ash and coal for the purpose of manufacture of cement and also purchases spare parts of machineries. On receipt of Audit Visit Report (AVR), statutory notice was issued to the dealer-assessee for assessment u/s. 42 of the OVAT Act. Pursuant to such notice, the dealer appeared through its Advocate and filed objection against the post visit recommendation by the Audit Visit Officer. His first objection was to the application of PQR method u/r. 11(1) of the OVAT Rules for determination of eligible ITC out of the total ITC claimed by the dealer and second objection was regarding disallowance of ITC

amounting to ₹37,68,400.00 on purchase of MS angles, plates, rods, borewell pumps, machinery spares, DC motors, submersible pumps, screw, valve, polythene elbow, nut bolt, bearing, PVC tapes, shower terminal cable, lamp, V-belt etc. His third objection was disallowance of ITC amounting to ₹3,96,096.00 on purchase of coal. While completing the assessment, learned assessing authority disallowed the ITC on purchase of capital goods amounting to ₹35,25,068.00. The assessing authority on verification of books of account and other materials on record, raised demand of ₹1,05,87,983.00 which included penalty of ₹69,16,562.00 and interest of ₹2,13,140.00.

2(a). The dealer-assessee challenging the demand raised by the assessing authority, filed appeal before the first appellate authority, who disagreed with the view of the assessing authority that the dealer-assessee is not entitled to ITC on purchase of iron and steel goods, spare parts of machineries, pump sets, motors, v-belts and other sundry store items and held that the dealer-assessee having utilized iron and steel goods, pump sets, motors, V-belts and other sundry store items in the integrated process of manufacturing is entitled to get set off of ITC. The first

appellate authority recomputed the tax liability of the dealer-assessee and reduced the demand to ₹8,01,282.00, which includes penalty of ₹5,34,188.00.

3. The State being aggrieved with the findings of the first appellate authority that the dealer-assessee is entitled to ITC on purchase of iron and steel goods, pump sets, motors, V-belts and other sundry store items, filed the present appeal on the ground that the first appellate authority committed serious error of law in holding that the above goods were capital goods, which directly go into the composition of finished product and the dealer-assessee was entitled to ITC on purchase of the same. No cross-objection has been filed by the dealer-respondent.

4. Learned Standing Counsel (CT) for the revenue challenging the impugned order of the first appellate authority vehemently urged that the first appellate authority in a very arbitrary and whimsical manner allowed ITC amounting to ₹31,91,187.00 without recording any independent finding that the goods in question are “capital goods” as claimed by the dealer-assessee, which go into the composition of finished products. The first appellate authority basing on the definition of “capital goods” as

contemplated u/s. 2(8) of the OVAT Act has held that the dealer, having utilized iron and steel goods, pump sets, motors, V-belts and other sundry store items in the integrated process of manufacturing, it is entitled to avail ITC. The first appellate authority has not discussed any other materials available on record to fortify its finding that the goods in question are capital goods and the same have been utilized in the integrated process of manufacturing. Learned first appellate authority committed serious illegality and grave error of law in holding the spare parts as capital goods and thereby allowing ITC on purchase of those goods. Therefore, the impugned order of the first appellate authority was unsustainable in the eyes of law.

5. Per contra, learned Counsel for the dealer-respondent supporting the impugned order of the first appellate authority contended inter alia that 'capital goods' means not only plant and machinery but also other equipments which are used in the process of manufacturing and without use of which the end product could not have been manufactured. The goods in question having been utilized in the integrated process of manufacturing, the first appellate authority was fully correct in its approach in

allowing the ITC on purchase of those goods. Learned assessing authority without taking note of the law laid down by the Hon'ble Apex Court and other Hon'ble High Courts in different judicial pronouncements, rejected the claim of ITC, which is illegal, unjust and unsustainable in the eyes of law. The first appellate authority in exercise of its appellate jurisdiction rightly corrected the errors committed by the assessing authority in holding the goods in question are not capital goods and allowed ITC on purchase of those goods. He further argued that the expression "in the manufacture of goods" should normally encompass the entire process carried on by the dealer of converting raw materials into finished goods. He also argued that when a particular process is so integrally connected with the ultimate production of goods but for that process, manufacture or processing of goods would be commercially inexpedient, goods required in that process would fall within the expression "in the manufacture of goods". The first appellate authority correctly took the view that the goods in question were utilized in the integrated process of manufacturing on account of which the dealer-assessee was entitled to ITC. The assessing authority disallowed the claim of ITC of the

dealer-assessee in a very whimsical and arbitrary manner without taking into consideration the law settled in different judicial pronouncements on the issue. The goods in question having been utilized in the process of manufacture, the first appellate authority did not commit any illegality in allowing the claim of ITC on purchase of the same. The appeal filed by the State being devoid of any merit, needs to be dismissed *in limine*.

6. We have heard the rival submissions of the parties, gone through the grounds of appeal vis-a-vis the impugned orders of the forums below and the materials on record. The crux of the dispute, as it appears from the rival contentions of the parties, is whether the goods such as MS angles, plates, rods, borewell pumps, machinery spares, DC motors, submersible pumps, screw, valve, polythene elbow, nut bolt, bearing, PVC tapes, shower terminal cable, lamp, V-belt are capital goods, which directly go into the composition of finished products and the dealer is entitled to ITC on purchase of those goods. On perusal of the impugned order of the assessing authority, we find that the dealer claimed ITC of ₹99,36,839.00 on purchase of capital goods, raw materials, consumables and packing materials from the

registered dealers inside the State, out of which it (dealer-assessee) disclosed non-creditable ITC of ₹6,20,208.00 relating to the goods despatched to outside the State on stock transfer basis and the net ITC claimed was ₹93,16,631.00. In the AVR, it was suggested to disallow the claim of ITC of ₹37,68,400.00 on purchase of MS angles, plates, rods, borewell pumps, machinery spares, DC motors, submersible pumps, screw, valve, polythene elbow, nut bolt, bearing, PVC tapes, shower terminal cable, lamp, V-belt, which were treated as capital goods and consumables by the dealer. The dealer-assessee before the assessing authority claimed ITC of ₹35,25,068.00 on purchase of such goods as against ₹37,68,400.00 as reported by the Audit Visit Team and in this connection, the dealer-assessee submitted a list of such goods and the amount of VAT involved in their purchase narrating in detail the claim of ITC of ₹35,25,068.00. The assessing authority interpreting the provisions of Section 2(8) of the OVAT Act and taking note of the law laid down in different judicial pronouncements held that the vehicles and spare parts are not capital goods, installation of plant and machinery relates to capital expenditure, whereas spare parts of machinery purchased

continually after a certain period do not fall under the definition of “capital goods”. The assessing authority further held that the claim of ITC on purchase of MS plate, angle and rod is not acceptable and accordingly, disallowed the claim of ITC of ₹35,25,068.00. In the appeal filed by the dealer-assessee, the first appellate authority relying on the judgments in the cases of K. Rasiklal & Co. Vs. State of Gujarat, reported in [1992] 86 STC 238 (Guj.); Star Paper Mills ltd. Vs. Collector of Central Excise, Meerut, reported in [1990] 76 STC 312 (SC) and CTO, Udaipur Vs. Rajasthan Taxchem Ltd., reported in [2007] 5 VST 529 (SC), disagreed with the findings recorded by the assessing authority while coming to the conclusion that the dealer having utilized iron and steel goods, pump sets, motors, V-belt and other sundry store items in the integrated process of manufacturing, it was entitled to ITC on purchase of the same. The first appellate authority further held that the dealer was not entitled to ITC on purchase of spare parts effected during the tax period under assessment and hence, disallowed the ITC amounting to ₹3,33,881.00 and allowed the balance amount of ITC of ₹31,91,187.00 out of the total claim of ITC of ₹35,25,068.00 disallowed by the assessing authority on

purchase of iron and steel goods, pump sets, motors, V-belts and other consumable items. The State filed the present second appeal challenging the impugned order of the first appellate authority allowing ITC of ₹31,91,187.00 by it. The dealer-assessee despite due service of notice, did not file any cross-objection challenging the finding of the first appellate authority that it (dealer-assessee) is not entitled to ITC of ₹3,33,881.00 on purchase of spare parts effected during the period under assessment. Therefore, the order of the first appellate authority to that effect became final.

7. Now, in the aforestated factual background, the legality and propriety of the order dated 30.01.2018 passed by the first appellate authority allowing the claim of ITC of ₹31,91,187.00 on purchase of iron and steel goods, pump sets, motors, V-belt and other consumable items holding the same as “capital goods” and are being used in the integrated process of manufacturing is to be examined. Before addressing on the issue, it is profitable to discuss some relevant provisions of the OVAT Act for better adjudication of the dispute involved in the present appeal.

Section 20(1) of the OVAT Act provides that –

"20. Input tax credit –

(1) Subject to the provisions of this Act, for the purpose of calculating the net tax payable by a registered dealer for any tax period, an input tax credit as determined under this section shall be allowed to such registered dealer against the tax paid or payable in respect of all sales or purchases taxable under this Act, other than sales or purchases of goods specified in Schedule C and Schedule D."

Section 20(5)(a) of the OVAT Act stipulates that –

"(5)(a) Input tax credit on capital goods shall be allowed from the date of first sale of taxable goods produced or manufactured after the commencement of such production and shall be adjusted against the output tax over a period not exceeding three years :

Provided that no input tax credit shall be allowed on such capital goods used for the purposes and in the circumstances as specified in Schedule D."

'Input' has been defined u/s. 2(25) of the OVAT Act as under:-

"Input" means any goods purchased by a dealer in the course of his business for resale or for use in the execution of works contract, in processing or manufacturing, where, such goods directly goes into composition of finished products or packing of goods for sale, and includes consumables directly used in such processing or manufacturing;"

According to Section 2(26) of the OVAT Act –

> "Input tax" in relation to any registered dealer means the tax collected and payable under this Act in respect of sale to him of any taxable goods for use in the course of his business, but does not include tax collected on the sale of goods made to a commission agent purchasing such goods on behalf of such dealer;"

Section 2(27) of the OVAT Act prescribes that –

> "Input tax credit" in relation to any tax period means the setting off of the amount of input tax or part thereof under Section 20 against the output tax, by a registered dealer other than a registered dealer paying turnover tax under Section 16;"

Section 2(8) of the OVAT Act prior to amendment on 01.06.2008 defines "capital goods" that –

> "Capital goods" means plants, machinery and equipments used directly in the process of manufacturing but does not include such plant, machinery and equipments which are used for the purposes and in the circumstances specified in Schedule D:"

7(a). On conjoint reading of the above provisions, it becomes abundantly clear that the ITC shall be allowed on purchases made within the State from registered dealer holding a valid certificate of registration in respect of the goods intended for the purpose of use as 'input' or as "capital goods" in the manufacturing or processing of goods. The Hon'ble Apex Court in the case of **J.K. Cotton Spinning**

& Weaving Mills Co. Ltd. Vs. Sales Tax Officer, Kanpur and others, reported in [1965] 16 STC 563 (SC), interpreting the provisions of Section 8(3)(b) of the CST Act, 1956 held that the expression "in the manufacture of goods" should normally encompass the entire process carried on by the dealer of converting raw materials into finished goods. Where any particular process is so integrally connected with the ultimate production of goods that, but for that process, manufacture or processing of goods would be commercially inexpedient, goods required in that process would fall within the expression "in the manufacture of goods". For example, in the case of a cotton textile manufacturing concern, raw cotton undergoes various processes before cloth is finally turned out. Cotton is cleaned, carded, spun into yarn, then cloth is woven, put on rolls, dyed, calendered and pressed. All these processes would be regarded as integrated processes and included "in the manufacture" of cloth. It would be difficult to regard goods used only in the process of weaving cloth and not goods used in the anterior processes as goods used in the manufacture of cloth. To read the expression "in the manufacture" of cloth in that restricted sense, would raise many anomalies. Raw cotton and

machinery for weaving cotton and even vehicles for transporting raw and finished goods would qualify under Rule 13, but not spinning machinery, without which the business cannot be carried on. Goods used as equipment, as tools, as stores, as spare parts, or as accessories in the manufacture or processing of goods, in mining, and in the generation and distribution of power need not, to qualify for special treatment under Section 8(1), be ingredients or commodities used in the process, nor must they be directly and actually needed for "turning out or the creation of goods". If a process or activity is so integrally related to the ultimate manufacture of goods so that without that process or activity manufacture may, even if theoretically possible, be commercially inexpedient, goods intended for use in the process or activity as specified in Rule 13 will qualify for special treatment. This is not to say that every category of goods "in connection with" manufacture of, or "in relation to" manufacture, or which facilitates the conduct of the business of manufacture will be included within Rule 13.

7(b). It is clear from the above legal position that the expression "in the process of manufacture of goods" is to be given a liberal construction to include not only the

process of actual production of finished goods, but also the processes which are integral part for the ultimate manufacture in the absence of which the manufacture may not be commercially expedient. The expression "in the manufacture of goods" normally encompasses the entire process carried on by the dealer of converting raw materials into finished goods. Adverting to the facts of the case in hand, the dealer-assessee claimed ITC on purchase of goods such as MS angles, plates, rods, borewell pumps, machinery spares, DC motors, submersible pumps, screw, valve, polythene elbow, nut bolt, bearing, PVC tapes, shower terminal cable, lamp, V-belt for ₹35,25,068.00 on the ground that those are "capital goods" which are used in the process of manufacturing, the learned assessing authority disallowed the entire claim of ITC holding that those are not "capital goods", whereas learned first appellate authority allowed the claim of ITC to the tune of ₹31,91,187.00 holding that those are capital goods. On careful reading of the orders of the forums below, we find that both the forums below have not returned any finding as to whether those goods are used in the process of manufacturing or not. If these goods are used in the process of manufacturing

without use of which the end products cannot be manufactured, the dealer-assessee is entitled to ITC on purchase of the same. Neither the assessing authority, who disallowed the claim of ITC nor the first appellate authority, who allowed the ITC to the tune of ₹31,91,187.00 answered the core issue whether the goods in question were required in the process of manufacturing and were so integrally connected without use of which the manufacture of end product was not possible. Learned first appellate authority resorting to definition of "capital goods" as contemplated in Section 2(8) of the OVAT Act has held that these goods are "capital goods" which are integrally connected in the process of manufacturing. It has not given any reason as to how these goods are integrally connected in the process of manufacturing while coming to such a conclusion. Therefore, the orders of the first appellate authority and the assessing authority cannot be sustained in the eyes of law.

7(c). It is also found from the statement produced by the dealer-assessee narrating in detail the goods, on which set off of ITC to the tune of ₹35,25,068.00 was claimed, that most of the goods are either spare parts of different kinds and other consumables. The dealer-assessee

did not produce any material evidence before this forum to satisfy us as to how these goods were integrally connected in the process of manufacturing. Therefore, under this circumstance, this forum feel it expedient to remit the matter back to the assessing authority in order to give an opportunity to the dealer-assessee to justify its claim that these goods are "capital goods" which were used in the process of manufacturing and these goods were so integrally connected in the process of manufacturing without use of which the end product could not be produced, i.e. cement.

8. In view of the discussions made above, we are of the considered view that the impugned order of the first appellate authority allowing the claim of ITC to the tune of ₹31,91,187.00 holding the same as capital goods and integrally connected in the process of manufacturing without giving any reason as to how these goods were integrally connected in the process of manufacturing is illegal, unjust and unsustainable in the eyes of law. As a corollary, the appeal filed by the State is allowed and the impugned orders of the forums below are hereby set aside to the extent indicated above. The matter is remitted back to the assessing authority to recompute the tax liability of the

dealer-assessee keeping in view the observations made herein above and to give reasonable opportunity of hearing to the dealer-assessee to substantiate its claim that the goods in question are “capital goods” and are integrally connected in the process of manufacturing for the purpose of claiming ITC u/s. 20(5) of the OVAT Act. The entire process shall be completed in accordance with law within a period of five months from the date of receipt of this order.

Dictated & Corrected by me

Sd/-
(A.K. Das)
Chairman

Sd/-
(A.K. Das)
Chairman

I agree,

Sd/-
(S. Mishra)
Accounts Member-II