IN THE CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL, CHENNAI

Service Tax Appeal No.42333 of 2016

(Arising out of Order in Original No. CHN.SVTAX-001-COM-21-2016-2017 dated 8.9.2016 passed by the Principal Commissioner, Service Tax – I, Chennai)

And

Service Tax Appeal No.42530 of 2018

(Arising out of Order in Original No. 92/2018 CH. N. GST (Commr.) dated 14.9.2018 passed by the Principal Commissioner of GST and Central Excise, Chennai North Commissionerate)

M/s. Cholamandalam Investment & Finance Company Ltd. **Appellant**
"Dare House"
No.2, Old No. 234, N.S.C. Bose Road
Chennai – 600 001.

Vs.

Commissioner of GST & Central Excise **Respondent**
Chennai North Commissionerate
Newry Towers, No. 2054 – I
2nd Avenue, Anna Nagar
Chennai – 600 040.

APPEARANCE:

Shri N. Sri Prakash, Advocate for the Appellant
Dr. S. Subramanian, Special Counsel for the Respondent

CORAM

Hon'ble Ms. Sulekha Beevi C.S., Member (Judicial)
Hon'ble Shri M. Ajit Kumar, Member (Technical)

Final Order No.40415 & 40416/2023

Date of Hearing: 31.05.2023
Date of Decision: 12.06.2023

Per M. Ajit Kumar,

The Appellant, M/s. Cholamandalam Investment & Finance Company Ltd. (CIFCL) are engaged in the business of financing activities such as automobile financing, consumer loan, loans against securities etc.

2. During the course of audit conducted by the officers of the Service Tax Commissionerate, it was noticed that CIFCL had not paid service tax on the 'delayed payment charges' collected from the borrowers who made loan repayments belatedly ie beyond the period stipulated in the agreement. Two orders have come to be passed by the Principal Commissioner, confirming service tax demands on 'delayed payment charges' under relevant sections of the Finance Act 1994 (herein after referred to as 'FA 1994'). Aggrieved by the above orders (impugned orders), the appellants are now before us in appeals.

3. The facts of the case are that CIFCL are engaged in the business of extending financial assistance against securities. As seen from the sample 'Loan Agreement' (herein after referred to as 'agreement') submitted by the appellant during the hearing, the loan provided under the agreement shall be for the period as specified in the schedule to the agreement [Para 1(b)]. The borrower is liable to pay interest on the loan amount from the date of disbursement of the loan at the rates specified in the schedule to the loan agreement [Para 2(b)]. The borrower is required to pay all taxes on interest, other taxes, other charges / outgoings whatsoever in respect of the agreement [Para 2(e)]. If the borrower defaults in remitting any amount, due to the company, pursuant to the agreement, the borrower shall pay the company an additional interest at the rate mentioned in the schedule to the agreement on the entire outstanding from the date of default till the date of settlement [Para 2(f)]. The borrower acknowledges that strict compliance of the repayment schedule is an essential condition for grant of loan and the time is the essence of the contract [Para 6].

The borrower was liable to pay a flat charge by way of 'collection charges' as stated in the schedule to the agreement [para 7(f)]. An 'event of default' occurs, if the borrower commits any default in the payment of principal or interest or any obligation of the borrower to the company when due and payable [Para 10(a)]. In case of any breach of terms or in case of any not happening as stated in the agreement, the company may utilize any document executed by the borrower to the purpose of selling the property of the borrower [Para 11(a)]. The company has the right to appropriate any payment due under loan agreement and made by the borrower towards this in any manner as the company deems fit [Para 12].

4. A special audit was conducted by the officers of the Service Tax Commissionerate, Chennai, on CIFCL wherein it was found that in pursuance of the loan agreement executed by the appellant with the borrowers, 'delayed payment charges' were being collected. These delayed payment charges are part of the contractual agreement and it appeared that it would not be considered as a normal interest on loan. Hence Show Cause Notices was issued to the appellant covering two time periods and also involving two separate legal issues as stated below.

(a) During the period up to 30.6.2012 The issue involved is whether CIFCL are liable to pay service tax on 'delayed payment charges' as per section 65(12) read with Section 65(105)(zm) of the Finance Act, 1994 under the classification heading 'Banking and Other Financial Services'.

(b) For the period with effect from 1.7.2012, whether 'delayed payment charges' would be taxable as a 'declared service' in the light of section 66E(e) of the Finance Act, 1994, which reads;

'(e)agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act'.

4.1 The learned Principal Commissioner vide his order dated 8.9.2016 has confirmed service tax demand of Rs.40,95,45,898/- along with appropriate interest, for issues stated at para 4(a) and (b) above, covering the period from 2011-12 to 2014-15. Penalties were also imposed under section 77(2) and 78 of the FA 1994. Further, vide Order in Original dated 14.9.2018, a demand of service tax of Rs.52,18,15,210/- was confirmed with interest along with penalty under sec. 76 of the FA 1994, for the issue at para 4(b) above, covering the period from April 2015 to January 2017. The appellant has assailed both the orders in their appeal.

5. We have heard Shri N. Sriprakash, learned counsel for the appellant and Dr. S. Subramanian, learned special counsel for the Department.

5.1 The learned counsel Shri N. Sriprakash has stated that the additional interest / delayed payment charges were nothing but interest and therefore could not be brought to tax for the period upto 30.6.2010 in light of Rule 6(2)(iv) of Service Tax (Determination of Value) Rules, 2006 (STR 2006). Further, he has stated that as an alternative plea that since the additional / delayed payment charges are treated as penal charges / damages, the same could not have been brought to tax. On the merits of the case the learned counsel relied upon Tribunal judgments in **Neyveli Lignite corporation Ltd. Vs. Commissioner of Customs, Central Excise and Service Tax [2021 (53) GSTL 401 (Tri. Chen.)]** and **South Eastern Coalfields Ltd. Vs. Commissioner of CGST and Central Excise [2021 (55) GSTL 549 (Tri. Del.)]**. They have also relied on para 7 and 9 of **CGST Circular No 178/10/2022-GST dated 03/08/2022** to submit that penalties for cheque dishonor etc. are not a consideration for tolerating an act or situation. They are rather amounts recovered for not tolerating an act or situation and to deter such acts. Further if at all they are payments ancillary to and naturally bundled with the principal supply and should therefore be assessed as the same rate as the principal supply. They have also contested the total value of the additional interest / delayed payment charges received by the appellant during the financial year 2013 – 14 as being Rs.57,60,30,785/- and not Rs.88,38,89,042/- as stated in the Order in Original under challenge. Previous audits have been conducted of their office by Service Tax Audit teams, hence he submitted that extended period of time cannot be invoked in this case. He prayed that the impugned orders be set aside.

6. The Special Counsel Dr. S. Subramanian has reiterated the points given in their written submissions and stated that delayed payment charges are part of 'administrative charges' which is subject to service tax both in the positive list of taxation and negative list of taxation. It is to be treated as consideration and has to be included in the value for discharge of service tax liability. He has also relied on para 7.1.6 of

CGST Circular No 178/10/2022-GST dated 03/08/2022 to submit that late payment charges constitute a consideration for the supply of a facility namely of acceptance of late payment and are hence taxable. Further in the Advance Ruling **In RE: New Tripura Area Development Corporation Ltd** [2021(51) GSTL 432 (AAR GST TN), it was held that interest on delayed payment was raised to tolerate the delay in realization of the full amount due. Further, the contention of the appellant that the total amount collected by them during the financial year was only a sum of Rs.57,60,30,785/- and not Rs.88,38,89,0421/- is not factually correct as the said amount shown is only upto September of the financial year and the whole financial year 2013 – 14, the same comes to Rs.88,38,89,042/- as worked out in the annexure to the Show Cause Notice. He further pointed out that the appellant had not declared the recovery of delayed payment charges collected by them in the ST-3 returns filed by the department nor have they approached the department seeking any clarification / advance ruling on the matter hence the inference is that they have deliberately suppressed the matter to evade payment of service tax. Hence the impugned orders may be confirmed.

7. We have gone through the appeals, cross objections and the connected papers and have heard representatives of both the parties. We find that the issue relates to the taxability of delayed payment charges received by the appellant from their customers under different provisions/ sections of FA 1994 for different periods, as applicable. We examine the matter issue wise.

A) The first issue is whether section 65(12) of the Finance Act, 1994 cover 'delayed payment charges' under the classification of 'Banking and Other Financial Services', up to 30/06/2012. As per section 65 (105) (zm) of FA 1994 "Taxable Service" means any service provided or to be provided to any person, by a banking company or a financial institution including a non-banking financial company or any other body corporate or commercial concern, in relation to banking and other financial services. It is seen that as per Para 6 of the agreement the borrower acknowledges that strict compliance of the repayment schedule is an essential condition for grant of loan and the time is the essence of the contract. The agreement hence indicates that the provision for delayed payment is not the reason for the agreement but only provides a safeguard to the commercial interest of the appellant. Hence the payment, unlike interest, is only a condition and not the consideration for the loan. The payment therefore cannot be treated as interest as claimed by the appellant. It is for this reason, as pointed out at para 21.1 of the impugned order, that in the Financial Statement (Annual Report 2012-13) the method of accounting of 'interest' and 'delayed payment charges' are done separately under different footings. However, what is of importance is the treatment given to 'delayed payment charges' in the impugned order. Para 18 of the impugned order refers to RBI instructions permitting only three components in the pricing of a loan viz the interest charge, the processing charge and insurance premium (which includes the administrative charge in respect thereof). It does not discuss and elaborate under which heading 'delayed payment charges' would fall and why. Further at para 20.1 of the impugned order 'delayed payment charges' are held to be in the nature of additional consideration so that the borrower is disincentivized for default with regards to its penal nature. At para 21 delayed payment charges are held to be a disincentive or penalty for default in payment of loan or a charge imposed for accepting such delayed returns. We find that penal payments in this case are charged because there is an unintended non-compliance to the terms of the agreement which cannot be held to be a consideration for the taxable service rendered by the appellant. Consideration is something paid or done in furtherance of the object or purpose for which the parties enter into a contract. Defaulting on the loan schedule cannot be said to be the object or purpose of the agreement. Hence the penal payment of 'delayed payment charges', cannot be held to be 'consideration' as per Explanation (a) to section 67 for providing a loan to any person as a taxable service, classifiable under 'Banking and Other Financial Services' of FA 1994, for the period prior to 30/06/2012. This being so the demand for service tax on this count must fail. Unlike FA 1994, provisions under Section 15 of the Central Goods and Services Tax (CGST) Act, 2017 relating to "Value of Taxable Supply", includes interest or late fee or penalty for delayed payment of any consideration for any supply and hence the Boards GST circular dated 03/08/2022 (supra), relied upon by both the parties would not be relevant to understand the legal issue involved in this case. Similarly, the Advance Ruling In RE: New Tripura Area Development Corporation Ltd, (supra) has been passed under the provisions of the GST Act and is distinguished.

B) For the period with effect from 1.7.2012 the issue involved is whether the appellant is providing a 'declared service" as per section 66E(e) of FA 1994. Revenue is of the view that the delayed payment charges are a consideration for the appellant tolerating the default in payment by the borrower by not exercising the recovery option by sale of securities provided by the borrower to the appellant at the time of securing the loan. The issue regarding what constitutes a consideration for agreeing to tolerate an act or a situation has been elaborately discussed and decided by coordinate Bench of this Tribunal in the case of **South Eastern Coalfields Ltd. Vs. Commissioner of CGST and Central Excise** (supra). The relevant paras of the judgment are reproduced below;

> "25. It is in the light of what has been stated above that the provisions of section 66E(e) have to be analyzed. Section 65B(44) defines *service* to mean any activity carried out by a person for another for consideration and includes a declared service. One of the declared services contemplated under section 66E is a service contemplated under clause (e) which service is agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act. There has, therefore, to be a flow of consideration from one person to another when one person agrees to the obligation to refrain from an act, or to tolerate an act, or a situation, or to do an act. In other words, the agreement should not only specify the activity to be carried out by a person for another person but should specify the:
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> (i) consideration for agreeing to the obligation to refrain from an act; or
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> (ii) consideration for agreeing to tolerate an act or a situation; or
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> (iii) consideration to do an act.
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> 26. Thus, a service conceived in an agreement where one person, for a consideration, agrees to an obligation to refrain from an act, would be a 'declared service' under section 66E(e) read with section 65B(44) and would be taxable under section 68 at the rate specified in section 66B. Likewise, there can be services conceived in agreements in relation to the other two activities referred to in section 66E(e).

> 27. It is trite that an agreement has to be read as a whole so as to gather the intention of the parties. The intention of the appellant and the parties was for supply of coal; for supply of goods; and for availing various types of services. The consideration contemplated under the agreements was for such supply of coal, materials or for availing various types of services. The intention of the parties certainly was not for flouting the terms of the agreement so that the penal clauses get attracted. The penal clauses are in the nature of providing a safeguard to the commercial interest of the appellant and it cannot, by any stretch of imagination, be said that recovering any sum by invoking the penalty clauses is the reason behind the execution of the contract for an agreed consideration. It is not the intention of the appellant to impose any penalty upon the other party nor is it the intention of the other party to get penalized.
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> 28. It also needs to be noted that section 65B(44) defines "service" to mean any activity carried out by a person for another for consideration. Explanation (a) to section 67 provides that "consideration" includes any amount that is payable for the taxable services provided or to be provided. The recovery of liquidated damages/penalty from other party cannot be said to be towards any service *per se,* since neither the appellant is carrying on any activity to receive compensation nor can there be any intention of the other party to breach or violate the contract and suffer a loss. The purpose of imposing compensation or penalty is to ensure that the defaulting act is not undertaken or repeated and the same cannot be said to be towards toleration of the defaulting party. The expectation of the appellant is that the other party complies with the terms of the contract and a penalty is imposed only if there is non-compliance.
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> 29. The situation would have been different if the party purchasing coal had an option to purchase coal from 'A' or from 'B' and if in such a situation 'A' and 'B' enter into an agreement that 'A' would not supply coal to the appellant provided 'B' paid some amount to it, then in such a case, it can be said that the activity may result in a deemed service contemplated under section 66E(e).
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> 30. The activities, therefore, that are contemplated under section 66E(e), when one party agrees to refrain from an act, or to tolerate an act or a situation, or to do an act, are activities where the agreement specifically refers to such an activity and there is a flow of consideration for this activity."

8. We find that a similar stand has been taken by coordinate benches of this Tribunal in Neyveli Lignite corporation Ltd. Vs. Commissioner of Customs, Central Excise and Service Tax and vide Final Order No. 40311/2023 dated 26.4.2023 in the case of M/s. Bharat Heavy Electricals Ltd. Vs. CGST & CE, Trichy. We concur with the same. In view of the above, we hold that service tax could not be levied on

'delayed payment charges' collected by the appellant from their customers from 01.07.2012 also.

9. As the issue does not survive on merits for the entire period of both the show cause notices, all the other issues related to valuation, interest and penalties etc. also do not survive.

10. In light of the discussions above, we set aside the impugned orders and allow the appeals with consequential relief, if any, as per law. The appeals are disposed off accordingly.

(Pronounced in open court on 12.6.2023)

(**M. AJIT KUMAR**)
Member (Technical)

(**SULEKHA BEEVI C.S.**)
Member (Judicial)

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