Customs, Excise & Service Tax Appellate Tribunal
West Zonal Bench At Ahmedabad

REGIONAL BENCH- COURT NO.3

Service Tax Appeal No.10405 of 2020

(Arising out of OIO-AHM-EXCUS-003-COM-005-19-20 dated 31/01/2020 passed by Commissioner of Central Excise, Customs and Service Tax-SERVICE TAX - AHMEDABAD)

GUJARAT STATE PETRONET LTD **.....Appellant**
Gspl Bhavan. Gidc Electronic Estate, Nr. K-7 Circle, Sector 26,
Gandhinagar, Gujarat

VERSUS

C.CGST & CEx-Gandhinagar **.....Respondent**
Commissioner,Central Gst & Central Excise, Custom House,Navrangpura
Ahmedabad, Gujarat-380009

APPEARANCE:
Shri Bharat Raichandani, Advocate for the Appellant
Shri Dinesh Prithiani, Assistant Commissioner (AR) for the Respondent

CORAM: HON'BLE MEMBER (JUDICIAL), MR. RAMESH NAIR
HON'BLE MEMBER (TECHNICAL), MR. RAJU

Final Order No. A/ 10957 /2022

DATE OF HEARING: 11.04.2022
DATE OF DECISION: 10.08.2022

RAJU

This appeal has been filed by M/s. Gujarat State Petronet Ltd. against confirmation of demand of service tax, interest and imposition of penalty.

02. Learned counsel for the appellant pointed out that the appellants are rendering various taxable services like Transmission of gas through pipelines, business support service, Man power supply service, etc. Learned counsel pointed out that a show cause notice dated 03.04.2018 was issued to them alleging that the appellants are charging and recovering certain amounts under the head of "liquidated damages" for delays in supply contracts or service contracts as per various agreements entered into between them and their vendors. The matter was heard at length and various arguments were extended by both the sides. Reliance on certain decisions was also made.

2.1 Learned counsel had relied on the decision of tribunal in the case of M/s. South Eastern Coalfields Ltd.- 2021 (55) GSTL J54 (SC). Most of the decisions relied by the learned counsel had taken the support of the

aforesaid decision of tribunal in the case of South Eastern Coalfields Ltd. (supra). The said decision was challenged before the Hon'ble Apex Court and appeal has been admitted reported at -2021 (54) GSTL J54 (SC).

03. To understand the exact nature of transaction, the learned counsel was asked to submit certain details of the documents to determine the exact nature of transaction however, by an affidavit of Shri Ajith Kumar TR, CFO of the appellant company it was submitted that the said request for additional data amounts to going beyond the show cause notice and therefore, the appellant had submitted that they are not in a position to submit the said information.

04. Meanwhile, it is noticed that the CBIC has issued a circular No.178/10/2022-GST dated 3rd August, 2022 in which it has stated its stand on the issue of taxability of various transactions claimed to be "liquidated damages". At the time of adjudication by commissioner and hearing before tribunal, this circular was not available on record and therefore, the adjudicating authority could not take benefit of the same. While the issue of levibility of service tax on liquidated damages is a debatable issue, the CBIC has vide Circular No. 178/10/2022-GST clarified its stand on the subject in respect of GST. In terms of Para 5(e) of Schedule-II of CGST Act as supply the following is an taxable transaction as deemed supplies.

SCHEDULE II

ACTIVITIES [OR TRANSACTIONS] TO BE TREATED AS SUPPLY OF GOODS OR SUPPLY OF SERVICES

5. Supply of services

The following shall be treated as supply of services, namely :—

(a) .....

(b) .....

(c) .....

(d) .....

(e) ***agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act; and***

(f) .....

In terms of section 66E(e) of the Finance Act, 1994 the following was a taxable transaction as a declared service, the same is reproduced below:-

> ***"66E. Declared services***
>
> ***The following shall constitute declared services, namely:-***
>
> ***.....***
>
> ***(e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act,"***

05. In the aforesaid circular dated 03.08.2022, the CBIC has clarified its stand on plethora of situation which includes the dispute in the instant case as well. The circular reads as follows:-

> *"In certain cases/instances, questions have been raised regarding taxability of an activity or transaction as the supply of service of agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act. Applicability of GST on payments in the nature of liquidated damage, compensation, penalty, cancellation charges, late payment surcharge etc. arising out of breach of contract or otherwise and scope of the entry at para 5 (e) of Schedule II of Central Goods and Services Tax Act, 2017 (hereinafter referred to as, "CGST Act") in this context has been examined in the following paragraphs.*
>
> *2. "Agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act" has been specifically declared to be a supply of service in para 5 (e) of Schedule I of CGST Act if the same constitutes a "supply" within the meaning of the Act. The said expression has following three limbs:*
>
> *a**. <u>Agreeing to the obligation to refrain from an act-</u>***
> *Example of activities that would be covered by this part of the expression would include non-compete agreements, where one party agrees not to compete with the other party in a product, service or geographical area against a consideration paid by the other party.*
>
> *Another example of such activities would be a builder refraining from constructing more than a certain number of floors, even though permitted to do so by the municipal authorities, against a compensation paid by the neighbouring housing project, which wants to protect its sunlight, or an industrial unit refraining from manufacturing activity during certain hours against an agreed compensation paid by a neighbouring school, which wants to avoid noise during those hours.*
>
> *b. <u>Agreeing to the obligation to tolerate an act or a situation-</u>*
> *This would include activities such a shopkeeper allowing a hawker to operate from the common pavement in front of his shop against a monthly payment by the hawker, or an RWA tolerating the use of loud speakers for early morning prayers by a school located in the colony subject to the school paying an agreed sum to the RWA as compensation.*
>
> *C. <u>Agreeing to the obligation to do an act-</u>*
> *This would include the case where an industrial unit agrees to install equipment for zero emission/discharge at the behest of the R WA of a neighbouring residential complex against a consideration paid by such RWA, even though the emission/discharge from the industrial unit was within*

permissible limits and there was no legal obligation upon the individual unit to do so.

3. The description "agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act" was intended to cover services such as described above. However, over the years doubts have persisted regarding various transactions being classified under the said description.

3.1. Some of the important examples of such cases are Service Tax/GST demands on –
i. Liquidated damages paid for breach of contract;
ii. Compensation given to previous allottees of coal blocks for cancellation of their licenses pursuant to Supreme Court Order;
iii. Cheque dishonour fine/penalty charged by a power distribution company from the customers;
iv. Penalty paid by a mining company to State Government for unaccounted stock of river bed material;
V. Bond amount recovered from an employee leaving the employment before the agreed period;
vi. Late payment charges collected by any service provider for late payment of bills;
vii. Fixed charges collected by a power generating company from State Electricity Boards (SEBs) or by SEBs/DISCOMs from individual customer for supply of electricity;
viii.Cancellation charges recovered by railways for cancellation of tickets, etc.

In some of these cases, tax authorities have initiated investigation and in some advance ruling authorities have upheld taxability.

4. In Service Tax law, "Service' was defined as any activity carried out by a person for another for consideration. As discussed in service tax education guide, the concept 'activity for a consideration' involves an element of contractual relationship wherein the person doing an activity does so at the desire of the person for whom the activity is done in exchange for a consideration. An activity done without such a relationship i.e., without the express or implied contractual reciprocity of a consideration would not be an "activity for consideration'. The element of contractual relationship, where one supplies goods or services at the desire or another, is an essential element of supply.

*5. The description of the declared service in question, namely, agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act in para 5 (e) of Schedule II of CGST Act is strikingly similar to the definition of contract in the Contract Act, 1872. The Contract Act defines 'Contract as a set of promises, forming consideration for each other. 'Promise' has been defined as willingness of the promisor' to do or to abstain from doing anything. *Consideration' has been defined in the Contract Act as what the promise' does or abstains from doing for the promises made to him.*

6. This goes to show that the service of agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act is nothing but a contractual agreement. A contract to do something or to abstain from doing something cannot be said to have taken place unless there are two

parties, one of which expressly or impliedly agrees to do or abstain from doing something and the other agrees to pay consideration to the first party for doing or abstaining from such an act. There must be a necessary and sufficient nexus between the supply (i.e. agreement to do or to abstain from doing something) and the consideration.

6.1 A perusal of the entry at serial 5(e) of Schedule II would reveal that it comprises the aforementioned three different sets of activities viz. (a) the obligation to refrain from an act, (b) obligation to tolerate an act or a situation and (c) obligation to do an act. All the three activities must be under an "agreement" or a "contract" (whether express or implied) to fall within the ambit of the said entry. In other words, one of the parties to such agreement/contract (the first party) must be under a contractual obligation to either (a) refrain from an act, or (b) to tolerate an act or a situation or (c) to do an act. Further some "consideration" must flow in return from the other party to this contract/agreement (the second party) to the first party for such (a) refraining or (b) tolerating or (c) doing, Such contractual arrangement must be an independent arrangement in its own right. Such arrangement or agreement can take the form of an independent stand- alone contract or may form part of another contract. Thus, a person (the first person) can be said to be making a supply by way of refraining from doing something or tolerating some act or situation to another person (the second person) if the first person was under an obligation to do so and then performed accordingly.

Agreement to do or refrain from an act should not be presumed to exist

*7. There has to be an express or implied agreement; oral or written, to do or abstain from doing something against payment of consideration for doing or abstaining from such act, for a taxable supply to exist. An agreement to do an act or abstain from doing an act or to tolerate an act or a situation cannot be imagined or presumed to exist just because there is a flow of money from one party to another. Unless there is an express or implied promise by the recipient of money to agree to do or abstain from doing something in return for the money paid to him, it cannot be assumed that such payment was for doing an act or for refraining from an act or for tolerating an act or situation. Payments such as liquidated damages for breach of contract, penalties under the mining act for excess stock found with the mining company, forfeiture of salary or payment of amount as per the employment bond for leaving the employment before the minimum agreed period, penalty for cheque dishonour 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; such amounts are for preventing breach of contract or non-performance and are thus mere 'events' in a contract. Further, such amounts do not constitute payment (or consideration) for tolerating an act, because there cannot be any contract: (a) for breach thereof, or (b) for holding more stock than permitted under the mining contract, or (c) for leaving the employment before the agreed minimum period or (d) for doing something leading to the dishonour of a cheque. As has already been stated, unless payment has been made for an independent activity of tolerating an act under an independent arrangement entered into for such activity of tolerating an act, , such payments will not constitute *consideration' and hence such activities will not constitute "*

supply" within the meaning of the Act. Taxability of these transactions is discussed in greater detail in the following paragraphs.

Liquidated Damages

7.1 Breach or non-performance of contract by one party results in loss and damages to the other party. Therefore, the law provides in Section 73 of the Contract Act, 1972 that when a contract has been broken, the party which suffers by such breach is entitled to receive from the other party compensation for any loss or damage caused to him by such breach. The compensation is not by way of consideration for any other independent activity; it is just an event in the course of performance of that contract.

7.1.1 It is common for the parties entering into a contract, to specify in the contract itself, the compensation that would be payable in the event of the breach of the contract. Such compensation specified in a written contract for breach of non-performance of the contract or parties of the contract is referred to as liquidated damages. Black's Law Dictionary defines Liquidated Damages' as cash compensation agreed to by a signed, written contract for breach of contract, payable to the aggrieved party.

7.1.2 Section 74 of the Contract Act, 1972 provides that when a contract is broken, if a sum has been named or a penalty stipulated in the contract as the amount or penalty to be paid in case of breach, the aggrieved party shall be entitled to receive reasonable compensation not exceeding the amount so named or the penalty so stipulated.

7.1.3 It is argued that performance is the essence of a contract. Liquidated damages cannot be said to be a consideration received for tolerating the breach or non-performance of contract. They are rather payments for not tolerating the breach of contract. Payment of liquidated damages is stipulated in a contract to ensure performance and to deter non-performance, unsatisfactory performance or delayed performance. Liquidated damages are a measure of loss and damage that the parties agree would arise due to breach of contract. They do not act as a remedy for the breach of contract. They do not restitute the aggrieved person. It is further argued that a contract is entered into for execution and not for its breach. The liquidated damages or penalty are not the desired outcome of the contract. By accepting the liquidated damages, the party aggrieved by breach of contract cannot be said to have permitted or tolerated the deviation or non-fulfilment of the promise by the other party.

7.1.4 In this background a reasonable view that can be taken with regard to taxability of liquidated damages is that where the amount paid as "liquidated damages' is an amount paid only to compensate for injury, loss or damage suffered by the aggrieved party due to breach of the contract and there is no agreement, express or implied, by the aggrieved party receiving the liquidated damages, to refrain from or tolerate an act or to do anything for the party paying the liquidated damages, in such cases liquidated damages are mere a flow of money from the party who causes breach of the contract to the party who suffers loss or damage due to such breach. Such payments do not constitute consideration for a supply and are not taxable.

7.1.5 Examples of such cases are damages resulting from damage to property, negligence, piracy, unauthorized use of trade name, copyright, etc. Other examples that may be covered here are the penalty stipulated in

a contract for delayed construction of houses. It is a penalty paid by the builder to the buyers to compensate them for the loss that they suffer due to such delayed construction and not for getting anything in return from the buyers. Similarly, forfeiture of earnest money by a seller in case of breach of "an agreement to sell' an immovable property by the buyer or by Government or local authority in the event of a successful bidder failing to act after winning the bid, for allotment of natural resources, is a mere flow of money, as the buyer or the successful bidder does not get anything in return for such forfeiture of earnest money. Forfeiture of Earnest money is stipulated in such cases not as a consideration for tolerating the breach of contract but as a compensation for the losses suffered and as a penalty for discouraging the non-serious buyers or bidders. Such payments being merely flow of money are not a consideration for any supply and are not taxable. The key in such cases is to consider whether the impugned payments constitute consideration for another independent contract envisaging tolerating an act or situation or refraining from doing any act or situation or simply doing an act. If the answer is yes, then it constitutes a supply' within the meaning of the Act, otherwise it is not a "supply"

7.1.6 If a payment constitutes a consideration for a supply, then it is taxable irrespective of by what name it is called; it must be remembered that a "consideration" cannot be considered de hors an agreement/contract between two persons wherein one person does something for another and that other pays the first in return. If the payment is merely an event in the course of the performance of the agreement and it does not represent the 'object', as such, of the contract then it cannot be considered 'consideration'. For example, a contract may provide that payment by the recipient of goods or services shall be made before a certain date and failure to make payment by the due date shall attract late fee or penalty. A contract for transport of passengers may stipulate that the ticket amount shall be partly or wholly forfeited if the passenger does not show up. A contract for package tour may stipulate forfeiture of security deposit in the event of cancellation of tour by the customer. Similarly, a contract for lease of movable or immovable property may stipulate that the lessee shall not terminate the lease before a certain period and if he does so he will have to pay certain amount as early termination fee or penalty. Some banks similarly charge pre- payment penalty if the borrower wishes to repay the loan before the maturity of the loan period. Such amounts paid for acceptance of late payment, early termination of lease or for pre-payment of loan or the amounts forfeited on cancellation of service by the customer as contemplated by the contract as part of commercial terms agreed to by the parties, constitute consideration for the supply of a facility, namely, of acceptance of late payment, early termination of a lease agreement, of pre-payment of loan and of making arrangements for the intended supply by the tour operator respectively. Therefore, such payments, even though they may be referred to as fine or penalty, are actually payments that amount to consideration for supply, and are subject to GST, in cases where such supply is taxable. Since these supplies are ancillary to the principal supply for which the contract is signed, they shall be eligible to be assessed as the principal supply, as discussed in detail in the later paragraphs. Naturally, such payments will not be taxable if the principal supply is exempt."

06. Thereafter the circular examines the taxability of the following items:-

- Agreeing to the obligation to refrain from an act-
- Agreeing to the obligation to tolerate an act or a situation-
- Agreeing to the obligation to do an act-
- Agreement to do or refrain from an act should not be presumed to exist
- Liquidated damages
- Compensation for cancellation of coal blocks
- Compensation for cancellation of coal blocks
- Cheque dishonor fine/penalty
- Penalty imposed for violation of laws
- Forfeiture of salary or payment of bond amount in the event of the employee leaving the employment before the minimum agreed period
- Compensation for not collecting toll charges
- Late payment surcharge or fee
- Fixed Capacity charges for Power
- Cancellation charges

07. Prime facie Para 5(e) of Schedule-II of CGST Act, is identically worded as Section 66E(e) of the Finance Act, 1994. The circular expresses the stand of CBIC in case of GST on an interpretation of an identical expression namely:-

> *"agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act."*

The circular was not available to the adjudicating authority when the matter was decided and he could not examine the issue in the light of the aforesaid circular. The issue in dispute can be decided in the light of the aforesaid circular.

08. Consequently, the impugned order is set aside and the matter is remanded to the original adjudicating authority to decide the issue afresh in the light of the arguments given in the aforesaid circular.

(Pronounced in the open court on 10.08.2022)

(RAMESH NAIR)
MEMBER (JUDICIAL)

(RAJU)
MEMBER (TECHNICAL)

Mehul