CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
ALLAHABAD

Service Tax Appeal No. 70183 of 2021

(Arising out of Order-in-Appeal No. NOI-EXCUS-001-APP-835-20-21 dated 23.12.2020 passed by the Commissioner (Appeals) CGST & Central Excise, Noida)

Commissioner of Service Tax, Central Excise & CGST, Noida .....**Appellant**
C 56/42, Renu Tower, Sector 62
Noida

Vs.

M/s. Bharat Heavy Electricals Ltd. .....**Respondent**
HRDI & PSNR Complex, Plot no. 25,
Sector 16-A, Noida

APPEARANCE:

Shri Manish Raj, Authorised Representative for the appellant
Shri Atul Gupta, Advocate for the respondent

CORAM:
HON'BLE MR AJAY SHARMA, MEMBER (JUDICIAL)
HON'BLE MR P ANJANI KUMAR, MEMBER (TECHNICAL)

FINAL ORDER No: 70200/2026

DATE OF HEARING : 10.04.2026
DATE OF DECISION : 02.06.2026

PER: AJAY SHARMA

This appeal has been filed by the Revenue, assailing the impugned Order-in-Appeal dated 23.12.2020 passed by the Commissioner (Appeals), whereby the learned Commissioner

(Appeals) allowed the appeal filed by the Respondent-assessee and set aside the Order-in-Original dated 31.03.2019.

2. The Respondent-M/s. Bharat Heavy Electricals Limited (BHEL) - a Public Sector Undertaking is engaged in providing total engineering solutions for conventional thermal and gas-based power projects. Its clientele includes national undertakings such as NTPC and NHPC, as well as Central and State Government entities and private sector parties. In the course of its operations, the Respondent, in its capacity as buyer/procurer, entered into contracts and agreements with various suppliers and vendors for the supply of goods and services.

3. Under the terms of the said contracts, the Respondent was entitled to recover '*penalties and/or liquidated damages*' from suppliers and vendors in the event of delayed delivery of contracted goods or services. During the period from 1.7.2012 to 31.3.2017, the Respondent recovered a total sum of Rs. 4,71,10,557/- on account of such '*penalties/liquidated damages*'.

4. The Department took the view that such recoveries constituted "consideration" for a taxable service rendered by the Respondent to its suppliers and vendors, falling within the ambit of a "declared service" under Section 66E(e) of the Finance Act, 1994 specifically, 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." Accordingly, a Show Cause Notice dated 06.04.2018 was issued to the Respondent, demanding service tax of Rs. 63,21,634/- on the aforesaid recoveries, along with applicable interest and penalty.

5. The said Show Cause Notice culminated in the Order-in-Original dated 31.03.2019, wherein the adjudicating authority confirmed the demand of service tax together with interest and penalty. The Respondent preferred an appeal before the learned Commissioner (Appeals), who, by the impugned Order dated 23.12.2020, allowed the appeal and held that the Respondent was not liable to pay service tax on the *'penalties/liquidated damages'* recovered from its suppliers/ vendors, thereby setting aside the demand. The Revenue has now approached this Tribunal by way of the present appeal.

6. The core legal issue that falls for consideration before us is:

> *"Whether the 'penalties and/or liquidated damages' recovered by the Respondent from its suppliers/vendors on account of delayed delivery of goods/services, under the terms of the contracts/agreements, constitute consideration for a taxable 'declared service' within the meaning of Section 66E(e) of the Finance Act, 1994 viz., 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' so as to attract service tax?"*

7. We have heard the rival submissions of the learned Authorized Representative for the Revenue and the learned Counsel for the Respondent, and have carefully perused the case records, the synopsis, the written submissions, and the case laws placed on record.

8. The foundational premise of the Revenue's case is that, when the Respondent allowed its suppliers/vendors to continue with performance despite delays, and thereafter recovered liquidated damages as contractually stipulated, it was in effect providing a service of "tolerating" the delayed act of the supplier. The Revenue seeks to bring such recoveries within the purview of Section 66E(e) of the Finance Act, 1994, which declares 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" as a taxable service.

9. We are unable to accept this line of reasoning. At the outset, it is essential to appreciate the legal character of liquidated damages and penalties under Contract law. A clause stipulating liquidated damages or penalties is a pre-agreed contractual mechanism to compensate the innocent party for loss suffered on account of breach or default by the other party. Far from being a "consideration" for any service rendered, such a recovery is fundamentally compensatory and remedial in nature. It represents an agreed measure of damages, a consequence of

breach and does not flow from any consensual service transaction.

10. For a transaction to attract service tax as a "declared service" under Section 66E(e), there must exist, at the very minimum, a bilateral and consensual arrangement whereby one party agrees, for consideration, to refrain from an act, tolerate a situation, or do something at the behest of the other. The element of agreement and mutual consensus to the "tolerating" of an act, in exchange for a defined consideration, is a *sine qua non*. In the present facts, no such independent agreement to tolerate delay existed. The liquidated damages clause is not a service agreement, it is a protective contractual provision that imposes a financial consequence upon the defaulting vendor. The act of recovering damages post-breach cannot be equated with an agreement to tolerate the breach itself.

11. The question is no longer res integra. It stands conclusively settled by the Principal Bench of this Tribunal in *South Eastern Coalfields Ltd. v. Commissioner of Central Excise and Service Tax, Raipur, reported at 2021 (55) GSTL 549 (Tri.-Del.)*. In that decision, after extensive deliberation, the Tribunal categorically held that penalty amounts, forfeiture of earnest money deposits, and liquidated damages received by an assessee cannot be treated as "consideration for tolerating an act," and therefore do not attract service tax under Section

66E(e) of the Finance Act, 1994. The relevant paragraphs of the said decision are extracted hereunder:-

> *"10. The issue that is involved is whether the appellant is providing a "declared service" contemplated under Section 66E(e) of the Finance Act, which service became taxable w.e.f. July 1, 2012. The period of dispute in the present appeal is from July, 2012 to March, 2016.*
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> *14. Liability has been fastened upon the appellant under Section 65B read with Section 66E(e) of the Finance Act for the period from July, 2012 till March, 2016 for the reason that by collecting the said amount the appellant had agreed to the obligation to refrain from an act or to tolerate the non-performance of the terms of the contract by the other party.*
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> *19. A Larger Bench of the Tribunal in Bhayana Builders (P) Ltd. v. Commissioner of Service Tax [2013 (32) S.T.R. 49 (Tri. - LB)] observed that implicit in the legal architecture is the concept that any consideration, whether monetary or otherwise, should have flown or should flow from the service recipient to the service provider and should accrue to the benefit of the latter. In the said decision, the Larger Bench made reference to the concept of "consideration", as was expounded in the decision pertaining to Australian GST Rules, wherein a categorical distinction was made between "conditions" to a contract and "consideration for the contract". It has been prescribed under the said GST Rules that certain "conditions" contained in the contract cannot be seen in the light of "consideration" for the contract and merely because the service recipient has to fulfil such conditions*

would not mean that this value would form part of the value of the taxable services that are provided.

20. The Supreme Court in Commissioner of Service Tax v. M/s. Bhayana Builders [2018 (2) TMI 1325 = 2018 (10) G.S.T.L. 118 (S.C.)], while deciding the appeal filed by the Department against the aforesaid decision of the Tribunal, also explained the scope of Section 67 of the Act. The Supreme Court observed that any amount charged which has no nexus with the taxable service and is not a consideration for the service provided does not become part of the value which is taxable under Section 67. … …

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24. What follows from the aforesaid decisions of the Supreme Court in Bhayana Builders and Intercontinental Consultants, and the decision of the Larger Bench of the Tribunal in Bhayana Builders is that "consideration" must flow from the service recipient to the service provider and should accrue to the benefit of the service provider and that the amount charged has necessarily to be a consideration for the taxable service provided under the Finance Act. Any amount charged which has no nexus with the taxable service and is not a consideration for the service provided does not become part of the value which is taxable. It should also be remembered that there is marked distinction between "conditions to a contract" and "considerations for the contract". A service recipient may be required to fulfil certain conditions contained in the contract but that would not necessarily mean that this value would form part of the value of taxable services that are provided.

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 :*

(i) consideration for agreeing to the obligation to refrain from an act; or
(ii) consideration for agreeing to tolerate an act or a situation; or
(iii) consideration to do an act.

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.*

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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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.

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32. In the present case, the agreements do not specify what precise obligation has been cast upon the appellant to refrain from an act or tolerate an act or a situation. It is no doubt true that the contracts may provide for penal clauses for breach of the terms of the contract but, as noted above, there is a marked distinction between *'conditions to a contract' and 'considerations for a contract'.*

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35. Reference can also be made to a decision of the Tribunal in Lemon Tree Hotel. The issue that arose for consideration was whether forfeiture of the amount received by a hotel from a customer on cancellation of the booking would be leviable to service tax under Section 66E(e). The Tribunal held that the retention of the amount on cancellation would not attract service tax under Section 66E(e) … …

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37. Much reliance has been placed by the Learned Authorized Representative of the Department on the decision of the Supreme Court in Fateh Chand. The submission is that the word "suffering" is synonymous to "tolerating" and the Supreme Court in Fateh Chand held that a reasonable compensation for breach of contract has to be proportionate to the actual injury suffered. Thus, according to the Learned Authorized Representative of the Department it has been acknowledged by the Supreme Court that in a case of breach of contract, one party tolerates an act or situation.

38. The decision of the Supreme Court in Fateh Chand does not help the Department. The facts indicate that the Delhi Improvement Trust had granted lease hold rights for ninety years to Dr. M.M. Joshi in respect of a property. … …

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41. The Supreme Court also noticed that Section 74 of the Contract Act merely dispenses with the proof of "actual loss or damages". It does not justify the award of compensation, when in consequence of the breach no

> *legal injury at all has resulted, because compensation for breach of contract can be awarded to make good the loss or damage which actually arose or which the parties knew when they made the contract 'to be likely to result from the breach'. The Supreme Court also found that there was no evidence that any loss was suffered by the plaintiff in consequences of the default by the defendant, save as to the loss suffered by being kept out of possession of the property. The Supreme Court, therefore, held that plaintiff would be entitled to retain only an amount of Rs. 1000/- that was received as earnest, out of amount of Rs. 25,000/-.*
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> *42. The conclusion drawn by the Learned Authorized Representatives of the Department from the aforesaid decision of the Supreme Court that compensation received is 'synonymous' with 'tolerating' or that the Supreme Court acknowledged that in a breach of contract, one party tolerates an act or situation is not correct.*
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> *43. It is, therefore, not possible to sustain the view taken by the Principal Commissioner that penalty amount, forfeiture of earnest money deposit and liquidated damages have been received by the appellant towards "consideration" for "tolerating an act" leviable to service tax under Section 66E(e) of the Finance Act."*

12. The validity and finality of the decision in *South Eastern Coalfields (supra)* is placed beyond doubt by a subsequent development whereby the Civil Appeal filed by the Department before the Hon'ble Supreme Court being Civil Appeal No. 2372 of 2021, was dismissed as withdrawn vide order dated 11.07.2023. The withdrawal of the Civil Appeal by the Department means

that the decision of the Tribunal has attained finality and constitutes binding precedent on the issue at hand.

13. The said precedent has been consistently followed by co-ordinate Benches of this Tribunal in numerous subsequent cases. Most pertinently the issue in the Respondent's own case, involving an identical fact pattern of the Respondent charging penalties and liquidated damages from suppliers and vendors for delayed delivery, came up for consideration before this Tribunal in Commissioner of *Central Excise & CGST, Noida v. M/s. Bharat Heavy Electricals Limited* and while relying upon, inter alia, the decision in *South Eastern Coalfields (supra)*, the Department's appeal was dismissed vide Final Order No.70562/2024 dated 07.08.2024. This ruling directly binds the present proceedings.

14. We are in respectful agreement with the reasoning and conclusions in *South Eastern Coalfields (supra)* and the subsequent line of authorities. The consistent judicial view is well-founded, both in principle and in the statutory language of Section 66E(e) ibid. Subjecting liquidated damages/contractual penalties to service tax would amount to a fundamental distortion of settled principles of contract law, converting what is essentially a remedial mechanism for breach into a taxable service, an outcome which has not been intended by the legislature.

15. In view of the foregoing discussion and the binding precedents referred to above, we find no merit in the present appeal filed by the Revenue. The impugned Order-in-Appeal passed by the learned Commissioner (Appeals) is just and proper and calls for no interference.

16. The appeal filed by Revenue is accordingly dismissed.

(Order pronounced in open court on 02.06.2026)

(AJAY SHARMA)
MEMBER (JUDICIAL)

(P. ANJANI KUMAR)
MEMBER (TECHNICAL)

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