

**CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
CHENNAI**

REGIONAL BENCH

SERVICE TAX APPEAL NO. 41666 OF 2016

(Arising out of Order-in-Original No. LTUC/251/2016-C dated 04.05.2016 passed by Commissioner of Central Excise & Service Tax, Large Taxpayer Unit, Chennai)

**M/s Neyveli Lignite Corporation
Limited, Neyveli**

No. 135, EVR Periyar High Road
Kilpauk, Chennai - 600010

...Appellant

VERSUS

**Commissioner of Customs,
Central Excise & Service Tax,**
Large Taxpayer Unit, Chennai – 600101

...Respondent

WITH

SERVICE TAX APPEAL NO. 41747 OF 2016

(Arising out of Order-in-Original No. LTUC/339/2016-C dated 20.06.2016 passed by Commissioner of Central Excise & Service Tax, Large Taxpayer Unit, Chennai)

**M/s Neyveli Lignite Corporation
Limited, Neyveli**

...Appellant

VERSUS

**Commissioner of Central Excise,
& Service Tax,**
Large Taxpayer Unit, Chennai – 600101

...Respondent

WITH

SERVICE TAX APPEAL NO. 41427 OF 2018

(Arising out of Order-in-Appeal No. TRY-ST-000-APP-29/2018/ dated 20.02.2018 passed by the Commissioner of GST & Central Excise, Trichy)

M/s NLC India Limited, Neyveli

...Appellant

VERSUS

**Commissioner of GST and
Central Excise, Trichy**

...Respondent

WITH

SERVICE TAX APPEAL NO. 41428 OF 2018

(Arising out of Order-in-Appeal No. TRY-ST-000-APP-40/2018/ dated 20.02.2018 passed by the Commissioner of GST & Central Excise, Trichy)

M/s NLC India Limited, Neyveli

...Appellant

VERSUS

**Commissioner of GST and
Central Excise, Trichy****...Respondent****AND****SERVICE TAX APPEAL NO. 42203 OF 2018**

(Arising out of Order-in-Original No. 16/COMMR/ST/2018 dated 22.06.2018 passed by the Commissioner of GST & Central Excise, Tiruchirapalli)

M/s NLC India Limited, Neyveli**...Appellant**

VERSUS

**Commissioner of GST and
Central Excise, Trichy****...Respondent****APPEARANCE:**Ms. Krithika Jaganathan, Advocate for the Appellant
Shri Balakumar and Shri L. NandaKumar, Authorized Representatives of the
Department**CORAM: HON'BLE MR. JUSTICE DILIP GUPTA, PRESIDENT
HON'BLE MR. P.V. SUBBA RAO, MEMBER (TECHNICAL)****Date of Hearing: July 20, 2021
Date of Decision: July 26, 2021****FINAL ORDER Nos. 41702-41706 / 2021****JUSTICE DILIP GUPTA:**

The dispute in all the five appeals relates to demand of service tax on liquidated damages recovered by the appellant for acts of default, like delayed or deficient supplies by various suppliers.

2. The period involved in all the appeals is after 01.07.2012 and the case set out by the Department is that the appellant had agreed to tolerate breach of timelines stipulated in the contract; the amount imposed as liquidated damages are consideration for the act of tolerating contractual default; and that the appellant had rendered declared service of 'agreeing to the obligation to refrain from an act, or

to tolerate an act or a situation or to do an act' contemplated under section 66E(e) of the Finance Act, 1994¹.

3. The appellant, formerly known as Neyveli Lignite Corporation India Limited, Neyveli, is a Public Sector Undertaking engaged in excavation of lignite from the captive mines at Neyveli in Tamil Nadu and at Barsingsar in Rajasthan. Lignite is principally consumed in the generation of electricity at the thermal power stations of the appellant.

4. All the five appeals have identical facts and so the facts of **Service Tax Appeal No. 41666 of 2016** are being narrated. The appellant executed a contract dated 10.08.2006 with Bharat Heavy Electricals Limited² for design, engineering, manufacture, supply, erection, testing, commissioning, and supply of two Circulating Fluidised Bed Combustion steam generators, complete with all accessories and auxiliaries and two Steam Turbines. Schedule IV to the Contract stipulates 'Times schedule and implementation strategy'. Clause 4.7.1 sets out the timelines. BHEL was required to complete successful performance guarantee tests for UNIT 1 within 35 months of date of Letter of Award and for UNIT 2 within 39 months of date of Letter of Award. Clause 4.9.1. states that time is the essence of the contract and liquidated damages would be levied in case BHEL fails to adhere to the time stipulated in clause 4.7.1. As BHEL failed to adhere to the above time limits, the appellant recovered liquidated damages in terms of the contract. Likewise, the appellant recovered liquidated damages for non-adherence to the time schedule for supplies from other contractors/Vendors.

5. A show cause notice dated 03.06.2015 was issued to the appellant calling upon the appellant to show cause as to why:

1 the Finance Act
2 BHEL

"(a) the amount of Rs. 8,52,58,879/- (Rupees Eight crore fifty two lakhs fifty eight thousand eight hundred and seventy nine only), being the service tax due on the liquidated damages recovered from the supplier / contractors by NLC, for the period July 2012 to Mar. 2015, should be recovered from them under *proviso* to Section 73(1) of the Finance Act, 1994;

(b) appropriate interest should not be charged on the said amount under Section 75 of the Finance Act, 1994;

(c) Penalty should not be imposed on them under Section 76 and 78 of the Finance Act, 1994."

6. Similar show cause notices were issued containing the same allegations.

7. The details of the period of dispute, the demand proposed, various sections under which penalty was imposed and the date of impugned order in the five appeals is provided in the following chart:

S. No.	Appeal No.	Date of Impugned Order	Period	Demand (INR)	Penalty (Sections)
1.	41666/2016	04.05.2016	2012-2015	8,52,58,879	76,78
2.	41747/2016	20.06.2016	2012-2014	3,66,58,998	76,78
3.	41427/2018	20.02.2018	2014-2015	1,21,37,422	76
4.	41428/2018	20.02.2018	2014-2015	9,23,925	76
5.	42203/2018	22.06.2018	2015-June 2017	14,17,27,361	76
Total				27,67,06,585	

8. The appellant submitted a detailed reply dated 03.07.2015 to the aforesaid show cause notice with a request that the proceedings

may be dropped for the reason that no service tax was payable on liquidated damages and penalties recovered under the contract.

9. The Commissioner did not accept the contentions raised by the appellant and confirmed the demand proposed. The relevant portion of the order dated 04.05.2016 passed by the Commissioner which has been impugned in is reproduced below:-

"14.5 In terms of Section 66E(e) above, the following activities, if carried out by a person for another for consideration would be treated as provision of service:

- a. Agreeing to the obligation to refrain from an act.
- b. Agreeing to the obligation to tolerate an act or a situation.
- c. Agreeing to the obligation to do an act.

The Taxpayer vide their reply has stated that the expression to tolerate an act under the declared services should be understood to cover instance where the consideration is being charged by one person in order to allow another person to undertake any particular activity. I find that in the present case, if BHEL not completed the task agreed upon within the time schedule, NLC agreed to tolerate the same for a consideration in the form of Liquidated damages as per the Schedule 4 of the Agreement. I find the above act of NLC are in relevance to the service covered under the term "Agreeing to the obligation to tolerate an act or situations the service" stated in Section 66E(e) of the Finance Act, 1994 and hence the same is taxable Service."

10. Ms. Krithika Jaganathan, learned counsel appearing for the appellant in all the five appeals made the following submissions:

- (i) A similar issue concerning service tax liability on liquidated damages has been decided in favour of the appellant in **M/s South Eastern Coalfields Ltd. vs. Commissioner of Central Excise and Service Tax, Raipur³**;
- (ii) Reliance has also been placed on the decision of the Tribunal **M.P. Poorva Kshetra Vidyut Vitran Co. Ltd. vs. Principal Commissioner CGST & Central Excise Bhopal⁴**, in support of

the contention that the amount of liquidated damages/penalty collected for non-compliance of the terms of the contracts cannot be subjected to levy of service tax; and

- (iii) Reliance has also been placed on a Larger Bench decision of the Tribunal in **Commissioner of Service Tax, Chennai vs. REPCO Home Finance Ltd.**⁵, wherein it has been held that 'foreclosure charges' collected by banks from borrowers for premature closure of loan account are not 'consideration' for banking services as foreclosure charges are 'damages' collected for breach of terms and conditions in the loan agreement and cannot be construed as 'consideration' for banking and other financial services.

11. Shri Balakumar and Shri L. NandKumar learned Authorized Representatives appearing for the Department have, however, supported the impugned orders and have submitted that they do not call for any interference as the demands have been confirmed in accordance with the provisions of section 66E(e) of the Finance Act.

12. The submissions advanced by the learned counsel for the appellant and the learned Authorized Representatives of the Department have been considered.

13. There is substance in the submission advanced by the learned counsel for the appellant that no service tax is payable on the amount collected towards liquidated damages as this issue has been decided by the Tribunal in favour of the appellant in **South Eastern Coalfields.**

14. Various commercial contacts had been executed by South Eastern Coalfields and certain clause provided for levy of penalty for non-observance / breach of the terms of the contract. A show cause

notice was issued with an allegation that the amount charged by the appellant during the period from July 2012 to March 2016 appeared to be taxable as a 'declared services' under section 66E(e) of the Finance Act.

15. The Principal Commissioner, however, did not accept the contention advanced on behalf of the appellant and confirmed the demand of service tax holding that the amount received by the said appellant towards penalty, earnest money deposit forfeiture and liquidated damages would tantamount to a consideration "for tolerating an act" on the part of the buyers of coal/contractors, for which service tax would be levied under section 66 E(e) of the Finance Act.

16. The Tribunal rejected the contentions advanced on behalf of the Department that penalty amount, forfeiture of earnest money deposit and liquidated damages had been received by the said appellant towards "consideration" for "tolerating an act" leviable to service tax under section 66E(e) of the Finance Act.

17. In this connection it would be appropriate to reproduce the relevant portions of the decision of the Tribunal in **South Eastern Coalfields**

18. .and they are as follows:

"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.

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).

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.”

19. This decision of the Tribunal in **South Eastern Coalfields** was followed by the Tribunal in **M.P. Poorva Kshetra Vidyut Vitran**.

20. In view of the aforesaid decisions of the Tribunal, it is not possible to sustain the view taken by the Commissioner that since BHEL did not complete the task within the time schedule, the appellant agreed to tolerate the same for a consideration in the form of liquidated damages, which would be subjected to service tax under section 66E(e) of the Finance Act.

21. As service tax could not be levied, the imposition of interest and penalty also cannot be sustained.

22. Thus, for all the reasons stated above, the orders dated 04.05.2016, 20.06.2016, 20.02.2018, 20.02.2018 and 22.06.2018 impugned in Service Tax Appeals No's 41666/2016, 41747/2016, 41427/2018, 41428/2018 and 42203/2018 respectively are set aside and the Appeals are allowed.

(Order pronounced on 26.07.2021)

(JUSTICE DILIP GUPTA)
PRESIDENT

(P V SUBBA RAO)
MEMBER (TECHNICAL)

Shreya