CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
NEW DELHI

PRINCIPAL BENCH

SERVICE TAX APPEAL NO. 52620 OF 2018

(Arising out of Order–in-Original No. 04/COMMR/ST/JBP dated 27.04.2018 passed by Commissioner, Central GST, Central Excise & Customs, Jabalpur)

Northern Coalfields Ltd. **...Appellant**

Versus

Commissioner CGST, CE & Customs - Jabalpur **...Respondent**

APPEARANCE:
Shri Hemant Sindhwani, Chartered Accountant for the Appellant
Shri Harshvardhan, Authorized Representatives for the Department

CORAM:

HON'BLE MR.JUSTICE DILIP GUPTA, PRESIDENT
HON'BLE MR. P. V. SUBBA RAO, MEMBER (TECHNICAL)

Date of Hearing/Decision: January 13, 2023

FINAL ORDER No.: 50050/2023

JUSTICE DILIP GUPTA

Northern Coalfields Limited[1] has filed this appeal to assail the order dated 27.04.2018 passed by the Commissioner for recovery of service tax with interest and penalty.

2. The appellant is a public sector undertaking and is a subsidiary of Coal India Ltd. It is primarily engaged in the business of extraction and selling of coal from open cast mines. The appellant has ten production units located in the State of Madhya Pradesh as well as in the State Uttar Pradesh. It, however, has separate order/product wise service tax registrations for applicable payment of service tax on reverse charge mechanism.

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1. the appellant

3. The appellant had recorded certain amount as income in the Financial Statements on account of compensation with caption of Penalty from Customer, Liquidated Damages and Penalty on Supplier. Such amount were booked in four different Financial Codes, and the nature of such bookings in the Financial Codes has been described by the appellant in the following manner:-

(a) Penalty /Liquidated Damages on Supplier of goods - As per the terms of Supply order, in case of delay in supplying the ordered goods or there is quality deficiency in supplied items, penalty at a specified percentage is charged on the concerned vendor. For the sake of convenience of accounting, instead of showing the net purchase cost, the agreed price of goods is debited (shown as expense) and the penalty amount is credited (shown as Income) separately.

(b) Penalty from Customers - This basically covers two types of bookings:

(1) As per Fuel Supply Agreement (FSA) generally entered with power house customers, there is a clause in the agreement which stipulates liability of the seller (Appellant) or the coal buyer in case of short delivery or lifting respectively, as the case may be. If for a particular financial year, the level of delivery by appellant company or the level of lifting by the buyer falls below the specified percentage in that year, the defaulting party shall be liable to pay compensation to the other party for such shortfall in level of delivery or level of lifting in the manner stated in the FSA.

(2) In respect of coal supplied by e-auction process, the successful bidder will be required to deposit coal value for supply in a month within a stipulated time period. In case the same is not paid by the successful bidder, the deposit money is forfeited by Appellant company. Further, in case the successful bidder who does not lifts coal within the stipulated time period, the deposit money is forfeited as compensation.

(c) Penalty Contractors & Others – If the contractor does not execute the subject contract in terms of the work order issued for any reason, compensation is charged and after deducting the compensation net amount (i.e. contract amount less penalty is paid to service provider). For the sake of convenience of accounting, instead of charging / debiting contract cost net of compensation, the entire value of work order is generally debited / booked as expense and compensation amount is credited/ booked as Income for control purpose.

4. A show cause notice dated 26.09.2017 was issued to the appellant under section 73(1) of the Finance Act 1994[2] mentioning therein that the appellant had collected an amount towards compensation/penalty from the buyers of coal on the short lifted/un-lifted quantity of coal; collected amount towards compensation/penalty from the contractors engaged for breach of terms and conditions; and collected amount in the name of damages from the suppliers of material for breach of the terms and conditions of the contract. According to the Department, this amount charged by the appellant during the period from July 2012 to March, 2016, would appear to be taxable as a declared service under section 66E (e) of the Finance Act. The show cause notice also invoked the extended period of limitation under the first proviso to section 73(1) of the Finance Act. The relevant portion of the show cause notice is reproduced below:-

> " M/s NCL was charging and collecting amount from the buyers of coal by way of forfeiture of EMD/SD for the short-lifted/un-lifted quantity of coal as non-compliance of terms & conditions of coal supply agreements. M/s NCL was also collecting amount in the name of compensation/penalty from the contractors engaged by them for providing various types of services viz. transportation, OBR removal, repair & maintenance service, works contract service etc. for breach of terms & conditions of the respective contracts. It was also noticed that NCL were also recovering/claiming amount in the name of liquidated damages from the material suppliers for breach of terms & conditions of the contracts. Accordingly, in terms of provisions of section 65B of the Finance Act, 1994 read with section 66E(e) ibid, such amount charged by NCL from the buyers of coal/service providers etc. under the respective agreements appears pertain to the declared services under clause (e) of section 66E attracting levy of

2. the Finance Act

> service tax. M/s NCL and its coal producing areas have recovered **Rs.111,01,92,788/-** towards EMD forfeitures, penalty & liquidated damages respectively from the buyers of coal, contractors and material suppliers during the period from July 2012 till March 2016. The location-wise details of amount collected under the above heads and the tax liability payable thereon by M/s NCL are tabulated as per **Annexure C-1 to C-8, D-1 to D-12 & E-1 to E-12.** The year-wise & area-wise details are consolidated in **Annexure- A & B** appended herewith. It therefore, appears that NCL & its coal producing areas had collectively evaded payment of service tax amounting to **Rs.14,11,36,387/-(incl. Cess)** on these declared services and the same appears liable to be recovered from them under section 73 of the Finance Act, 1994 alongwith interest under section 75 ibid."

5. The appellant submitted a reply to the show cause notice contending that penalty clauses were provided in the contract so that the parties to the contract did not breach the clauses repeatedly as financial consequences flow and that such penal clauses were invoked only in cases where party to the contract did not adhere to the terms of the contract. It was also stated that the appellant collects penalty (compensation) and forfeits security deposit/earnest money deposit for non-compliance of the terms of contract from buyers of coal on the quantity of un-lifted/short lifting of coal in terms of Coal Supply Agreement and not for tolerating any act or situation. The appellant also pointed out that penalty is charged from the vendors if there was a delay in supply of goods ordered by the appellant and that penalty is charged if the contractor also does not execute the terms of the contract in time. Such amount received by the appellant is shown in the books of the appellant under the head "Liquidated Damages & Penalty Recovered". The appellant also stated that the extended period of limitation could not have been invoked in the facts and

circumstances of the case and neither interest nor penalty was imposable.

6. The Principal Commissioner, however, did not accept the contentions advanced on behalf of the appellant and confirmed the demand of service tax holding that the amount received by the 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. The relevant portion of the order is reproduced below:

> 31.1. The Noticee's contention that the levy of service tax is on activity falling within the meaning of service and not for supply of goods. I find that the Noticee is not only recovering penalty from service contractors and buyers of coal on account of non-performing the work as desired and short or non-lifting of coal as per the agreement. The service contractors are undoubtedly the service providers and there is no dispute in regards to penalty, liquidated damage charges, against delay in delivery of work and non-fulfillment or violation of contract as agreed upon. Further, the purchase of coal and lifting of coal by the buyers are also activities. The sale and purchase cannot be ruled out from the scope of term 'activities'. The activity of purchase and lifting of goods is service and if the penalty is imposed or recovered on the failure of lifting or short lifting or cancellation by the seller from the buyers, then the penalty is a consideration to tolerate the failure to lift/short lift/cancel the desired quantity of purchase within time against the likely loss on any counts to be fell on the seller/vendor.
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> 31.2 Further, the Notice's contention that any action relating to the trading of goods will not be service and not attract the provisions of 66E as the activity of trading of goods is a non-taxable service as per section 66D effective from 1st July 2012 does not hold good and misplaced. I find that the Notice is mingling two activities i.e. the sale/supply of goods and penalty recoverable/imposable on failure to lift the desired quantity of goods. Similarly the activities i.e. provision of service by service contractors and penalty

> recoverable/imposable on failure to provide the desired service. Here the service tax is proposed on the penalty imposed/recovered against toleration of act of failure on the part of buyers and service contractors to carry out the contracted job as per terms and conditions of contract. To tolerate an act or to refrain from an act for which consideration in the name of penalty or whatever is received/collected is a taxable service made effective from 01.07.2012 under 'declared service' under section 66E(e) of Finance Act 1994.

7. Shri Hemant Sindhwani, learned Chartered Accountant appearing for the appellant submitted that the issue is covered by the decision of the Tribunal in **South Eastern Coalfields Ltd**. v/s **Commissioner of Central Excise & Service Tax, Raipur**[3] which was subsequently followed in **M/s Krishnapatnam Port Company Limited** v/s **Commissioner of Central Excise & Service Tax, Guntur**[4]**.** Learned Consultant also submitted that the Government of India, Ministry of Finance, Department of Revenue (Tax Research Unit) has also issued a Circular dated 03 August, 2022 relating to applicability of goods and service tax on payments in the nature of liquidated damages, compensation, penalty, cancellation charges, late payment surcharge arising out of breach of contract in which 'agreeing to the obligation to refrain from an act or to tolerate an act, or to do an act has been explained in detail and it has been held that this would not attract levy of service tax.

8. Shri Harshvardhan, learned authorized representative appearing for the Department has, however, supported the impugned order.

9. The submissions advanced by the learned authorized representative of the appellant and the learned authorized

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3. 2021 (55) G.S.T.L. 549 (Tri.-Del) decided on 22.12.2020
4. Service Tax Appeal No. 30227 of 2016 decided on 25.04.2022

representatives of the Department have been considered.

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.

11. Section 65B(44) of the Finance Act defines "service" to mean any activity carried out by a person for another for consideration, and includes a declared service, but does not include what is mentioned in "a, b and c". The relevant portion of the definition of "service" is reproduced below:

> **"Section 65B(44)**
> "service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include-
> (a) an activity which constitutes merely,-
> (i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or
> (ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of article 366 of the Constitution; or
> (iii) a transaction in money or actionable claim;
> (b) a provision of service by an employee to the employer in the course of or in relation to his employment;
> (c) fees taken in any Court or tribunal established under any law for the time being in force.‖

12. "Declared services" have been defined in section 66E and sub-section(e) of section 66E, which is involved in this appeal, is as follows :

> **"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;

13. The show cause notice and the impugned order indicate that the appellant was charging and collecting an amount under the following three heads:

(i) Compensation/penalty from the buyers of coal on the short-lifted/un-lifted quantity of coal and non- compliance of the terms and conditions of the Coal Supply Agreement, including forfeiture of earnest money deposit/security deposit;

(ii) Compensation/penalty from the contractors engaged by the appellant for providing various types of services for breach of the terms and conditions of the contract; and

(iii) Liquidated damages from the suppliers of materials for breach of the terms and conditions of the contract.

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.

15. Section 65B (44) defines 'service'to mean any activity carried out by a person for another person for consideration, and includes a declared service. Under section 66E (e), a declared service shall constitute agreeing to the obligation to refrain from an act, or to tolerate an act or situation, or to do an act. Section 66 B provides that service tax shall be levied at the rate of 12 per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed. Section 66D contains a negative list of services, while section 66E contains a list of declared services.

16. 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:

a. consideration for agreeing to the obligation to refrain from an act; or
b. consideration for agreeing to tolerate an act or a situation; or
c. consideration to do an act.

17. 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).

18. In **South Eastern Coalfields**, the Tribunal examined at length the provisions of section 66E(e) of the Finance Act and made the following observations:-

> " **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.

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'."

19. The issue in the present case is covered by the aforesaid decision rendered by the Tribunal and, therefore, it has to be held that service tax could not have been demanded from the appellant.

20. In this connection it would also be pertinent to refer to the Circular dated 03.08.2022 issued by the Department of Revenue regarding applicability of goods and service tax on liquidated damages, compensation and penalty arising out of breach of contract in the context of 'agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act'. This Circular emphasizes that there has to be an express or implied agreement to do or abstain from doing something against payment of consideration for a taxable supply to exist and such an act or a situation cannot be imagined or presumed to exist merely because there is a flow of money from one party to another. It also mentions that unless payment has been made for an independent activity of tolerating an act under an independent arrangement entered into for such activity or tolerating an act, such payment will not constitute 'consideration' and such activities will not constitute 'supply'. The relevant portion of the Circular is reproduced below:

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

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."**
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> **(emphasis supplied)**

21. Thus, for all the reasons stated above, it is not possible to sustain the order dated 27.04.2018 passed by the Commissioner. It is accordingly, set aside and the appeal is allowed.

(Order pronounced in the open Court)

(JUSTICE DILIP GUPTA)
PRESIDENT

(P. V. SUBBA RAO)
MEMBER (TECHNICAL)

Rekha