

**CUSTOMS, EXCISE AND SERVICE TAX APPELLATE TRIBUNAL
MUMBAI**

WEST ZONAL BENCH

SERVICE TAX APPEAL NO: 86225 OF 2021

[Arising out of Order-in-Original No: 98/MA/Commissioner/Belapur/2020-21 dated 31st March 2021 passed by the Commissioner of GST & Central Excise, Belapur.]

Reliance Industries Ltd

Building No. 8D, 1st Floor, Reliance Corporate Park
T B Road, Ghansoli, Navi Mumbai - 400701

...Appellant

versus

Commissioner of CGST & Central Excise

Belapur
CGO Complex, CBD Belapur, Navi Mumbai - 400614

...Respondent

APPEARANCE:

Shri Vishal Agarwal with Shri Abhishek Deodhar, Advocates for the appellant

Shri Anand Kumar, Additional Commissioner (AR) for the respondent

CORAM:

HON'BLE MR S.K. MOHANTY, MEMBER (JUDICIAL)

HON'BLE MR C J MATHEW, MEMBER (TECHNICAL)

FINAL ORDER NO: A/85026/2023

DATE OF HEARING:	02/01/2023
DATE OF DECISION:	02/01/2023

PER: S.K. MOHANTY

Heard both sides.

2. This appeal is directed against the impugned order dated 31st March 2021, wherein the Learned Commissioner of GST and Central Excise, Belapur has confirmed service tax demand of ₹ 83,35,72,810/- along with interest and also imposed penalties under Section 77 and 78 of Finance Act, 1994 on the appellant.

3. Briefly stated, the facts of the case are that the appellant herein is engaged in providing various taxable services, defined under Section 65(44) of the Finance Act, 1994. During the course of audit of accounts of the appellant, the department had observed from the Trial Balance for the financial year 2014 to June 2017 that the appellant had shown income under the head 'Liquidated Damages Deduction – Pending Decision' and 'Penalty/ Compensation recovered from the Contractors'. Considering such entries made in the books of accounts, the department had observed that the appellant receiving damages/compensation from the service provider should be considered as declared service, as per the provisions contained in Section 66E(e) of Finance Act, 1994. Accordingly, proceedings were initiated for confirmation of the adjudged demands on the appellant, which were confirmed in the impugned order dated 31/03/2021.

4. Learned Advocate appearing for the appellant submitted that the amount received by the appellant under the head Liquidated Damages and Penalty cannot be termed as 'consideration' for the purpose of levy of service tax on the

amount so collected from the service receivers/service providers. He has relied upon the decisions of this Tribunal in the case of *Madhya Pradesh Poorva Kshetra Vidyut Vitaran Company Ltd v. Commissioner of CGST & Central Excise* [Final Order No. 50329-50333/2022 dated 12th April 2022 in appeal No. 50289 of 2019 and others], *Western Coalfields Ltd v. Commissioner of CGST & Central Excise* [2022 (9) TMI 741 – CESTAT MUMBAI] and *South Eastern Coalfields Ltd v. Commissioner of Central Excise & Service Tax, Raipur* [2021 (55) GSTL 549 (Tri.-Del.)] to strengthen the case of the appellant that the amount received from the service providers as per the contractual norms should not form part of the taxable value for the purpose of levy of service tax thereon. He has also relied upon the Circular No. 178/10/2022-GST dated 3rd August 2022 to state that the Central Board of Indirect Taxes has accepted the position that the compensation received for breach of contract should not form part of the taxable value for the purpose of computation of service tax liability.

5. On the other hand, Learned Authorised Representative appearing for Revenue reiterated the finding recorded in the impugned order.

6. Heard both sides and perused the records.

7. We find that the Tribunal in the case of *Madhya Pradesh Poorva Kshetra Vidyut Vitaran Company Ltd (supra)* has dealt an

identical issue and has held against the Revenue, holding that the amount received as compensation for breach of contract should not be considered as taxable service within the purview of 'declared service' as per Section 66E *ibid*. We also find that the Tax Research Unit of the Department of Revenue in the Ministry of Finance *vide* Circular dated 3rd August, 2022 has specifically clarified that the compensation received on account of breach of contract should not form part of declare service for the purpose of payment of service tax by the assessee. Relevant paragraph of the said circular is extracted below.

'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 Circular No. 178/10/2022-GST 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 prepayment 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.'

8. In view of the above clarification furnished by CBIC and the decisions rendered by the Tribunal, we do not find any merits in the impugned order passed by the Learned adjudicating authority. Accordingly, by setting aside the impugned order the appeal is allowed in favour of the appellant.

(Dictated and Pronounced in Open Court)

(C J MATHEW)
Member (Technical)

(S.K. MOHANTY)
Member (Judicial)

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