CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL, MUMBAI

REGIONAL BENCH - COURT NO. I

Service Tax Appeal No. 90043 of 2018

(Arising out of Order-in-Original No. PUN-EXCUS-001-COM -010/18-19 dated 24.08.2018 passed by the Commissioner of Central Excise & GST, Pune-I)

M/s Bajaj Finance Ltd. **.... Appellant**
4th Floor, Unit No. 401 to 412,
Sr. No. 208/1B, Bajaj House, Lohegaon,
Pune - 411014

Versus

Commissioner of Central Excise & GST, Pune-I **.... Respondent**
GST Bhawan, 41-A, Sasoon road, Pune - 411001

Appearance:

Shri Vinay Jain, Advocate for the Appellant
Shri Nitin Ranjan, Authorized Representative for the Respondent

CORAM:

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

FINAL ORDER NO. A/86171/2023

Date of Hearing: 06.04.2023
Date of Decision: 07.08.2023

Per: M.M. Parthiban

This appeal has been filed by M/s Bajaj Finance Limited (herein referred to as 'appellants' for short) with address at 4th Floor, Unit No.401 to 412, Sr. No.208/1B, Bajaj House, Lohegaon, Pune-411014,against Order-in-Original No. PUN-EXCUS-001-COM-010/18-19 dated 24.08.2018 (referred to as 'impugned order') passed by Commissioner, Central Excise and Central Goods &Service Tax, Pune-I Commissionerate, Pune.

2.1. Briefly stated, the facts of the case are that the appellants herein are registered with jurisdictional Commissionerate under service tax centralized registration No.AABCB1518LST001 for providing taxable services under the category 'Banking and Other Financial Services' as per the Finance Act, 1994.

2.2. The appellants herein are a Non-Banking Financial Company(NBFC) engaged in the business of providing various types of finance such as auto loans, personal loans, consumer durable loans, loan against property etc. to various customers/borrowers. The appellants have entered into agreements with their customers/borrowers for providing loans to them and collect various charges from customers/borrowers such as processing fees, documentation fees, logging fees, loans statement issuance charges etc. as per terms and conditions of the loan agreement. The appellants are duly paying service tax on such charges collected from the customers/borrowers. The loan agreements, *inter-alia*, provide for repayment of the outstanding dues/Equated Monthly Instalments (EMI) through Cheques/Electronic Clearing System (ECS) or any other electronic or clearing mandate on the due dates stipulated in the agreement. In case of delay in payment of dues by the customers/borrowers, the appellants collect 'penal interest' as an additional interest for the number of days of delay in terms of the agreement executed by the customers/ borrowers. This penal interest is calculated at a fixed percentage on the overdue loan amounts, and it normally varies from customer to customer, and generally ranges between 2% to 4% per month. In addition to the above, the appellants also collect 'bounce charges' on account of dishonour of cheque/ ECS or any other electronic or clearing mandate given by the customers/ borrowers, which is in line with agreed terms and conditions. This bounce charges are generally a fixed amount per default committed by the customer, for e.g., Rs.350/- for each dishonour of Cheque/ECS. The Department had interpreted that the penal interest/bounce charges are not part of EMI of the loan amount or principal loan amount, and these are extra amounts imposed by the appellants as penal interest/bounce charges, which are accounted in the profit and loss accounts. Hence, the Department treated the same as a compensation received by the appellants on account of delay in payment of EMI by the customer/borrower, and these are part of consideration for declared services provided by the appellants i.e., service of tolerating the act of delay/default by customers/borrowers. Accordingly show cause proceedings were initiated for recovery of service tax during the disputed period July, 2012 to March, 2016 for an amount of Rs.53,87,14,050/- by issue of SCN No.07R-I/DN-V/GST-I/Audit-I/COMMR/2017-18 dated 15.01.2018. The said show cause notice was adjudicated by the learned Commissioner in concluding that the activity of appellants in tolerating the act of 'default and non-payment and late payment in payment of EMI by the borrowers & customers and dishonor of payment

instruments given by them towards repayment of loan installments' as 'Declared Service' of 'agreeing to tolerate an act or situation' in terms of Section 66(E)(e) read with Section 65B(22) of the Finance Act, 1994 and thereby treating it as 'service' in terms of Section 65B(44) and 'taxable service' under Section 65B(51) of the said Finance Act. Accordingly, the learned Commissioner passed the impugned order for recovery of adjudged demands besides imposition of penalty under section 77, 78 of the Finance Act, 1994.The appellants having been aggrieved by the impugned order passed by the learned Commissioner, Central Excise & GST, Pune-I, had filed this appeal before the Tribunal.

3.1. Learned Counsel appearing for appellants submits that they were under *bonafide* belief that the penal interest collected by them was in the nature of additional interest on the loans/advances provided by them and the same was exempt from payment of service tax. Further, the appellants were also under *bonafide* belief that bounce charges collected from their customers/borrowers was merely in the nature of penalty or liquidated damages or compensation for the breach of the terms and conditions of the loan agreement, and accordingly, the same was not leviable to service tax.

3.2 Learned Counsel appearing for the appellants also submitted that the appellants and borrowers enter into a contract wherein the appellants agree to grant loan in consideration for payment of interest and return of the principal amount on the due date. Thus, he claimed that the borrower is under an obligation to pay back the loan amount on the due date. In case, the borrower fails to pay the said amount at the time specified, it amounts to breach of the contract. This compensation/damages for breach of contract are not a consideration for any service.

3.3 He further stated that in the present case, there is only one contract between the Appellant and the borrower, which is the agreement for loan, for which consideration is payable by the borrower in the form of interest. Upon breach of contract, the liquidated damages become payable not as a consideration for the contract but as a compensation for damage suffered due to breach of the contract. Their agreement is for performance of the contract and not for its breach. Thus, he claimed that the provisions of Section 66E(e) is not applicable in the present case.

3.4. Learned Advocate also stated it is a settled position of law that damages/penalty/compensation for breach of contract is not consideration for any service and thus not leviable to service tax. In this regard, he placed reliance on the following judicial decisions, wherein the Courts have held that amounts paid in the nature of damages, would not be susceptible to service tax:

a) *Commissioner of Service Tax, Chennai v. Repco Home Finance Limited – 2020-TIOL-1039-CESTAT-MAD-LB,*
b) *South Eastern Coalfields Ltd. v. CCE, 2021 (55) G.S.T.L. 549 (Tri. - Del.)]*
c) *Neyveli Lignite Corporation Ltd. v. CCE, 2021 (53) G.S.T.L. 401 (Tri. - Chennai),*
d) *Reliance Life Insurance Company Ltd. v. Commissioner of Service Tax, Mumbai-II, 2018-TIOL-1308-CESTAT-MUM*,.
e) *Religare Securities Limited v. Commissioner of Service Tax, 2014-TIOL-539-CESTAT-DEL*

Hence, they pleaded that their appeal be allowed by setting aside the impugned order.

4.1.Learned Authorised Representative for Revenue submits that the activity of the Appellants is covered under Section 66E(e) of the Finance Act, 1994 as "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act". The consideration is paid by the customer in form of two payments (i) Penal Interest and (ii) Bounce Charges. As per agreement entered between the appellants and borrowers, it is clear that the default in payment of EMIs is hereby deemed to be default under the provisions of agreement entered between appellant and customers. Further, on any default or breach of the agreement the remedies available with the appellants are either to recall loan or cancellation of agreement, initiation of legal proceedings under Negotiable Instruments Act, 1881, or as the case may be under Payments and Settlement Systems Act, 2007, taking possession of the product, etc. However, the appellant instead of taking recourse to the remedial provisions in the agreement itself is tolerating the act or the situation of delay in payment of EMI by customers, by imposing/recovering penalty as envisaged under the terms of the agreement. Hence, such an activity of tolerance of situation of delay in payment of EMI is adequately covered in the second expression 'to tolerate an act' provided in clause 5(e) of Schedule II to the CGST Act, 2017 enumerating activities or transactions to be treated as supply of goods/ services. Such a tolerance of an activity of delay in payment is against the agreed consideration and it is in the form of penal charges/penalty. It is agreed between appellant and borrower/customer that

in case any delay has occurred, the appellants are entitled to recover the penal charges/penalty from such defaulting borrowers.

4.2. In view of the above submissions made by him, the Learned AR by reiterating the findings made in the impugned order, had stated that the appellants are liable to pay service tax on the penal interest, bounce charges received by the appellants from their customers/borrowers during the relevant period as part of taxable services.

5. The submissions advanced by the learned Advocate appearing for the appellants and the learned Authorized Representative of the Department have been considered. We have also perused the records of the case.

6. We find that the issue for consideration before us is to determine whether service tax is liable to be paid in respect of penal interest and bouncing charges, more fully described below,

(i) penal interest or delayed payment charges in case of late payment of EMI or delay in payment of periodical installments of loan/advance repayments, and

(ii) bouncing charges i.e., charges recovered for bouncing of repayment instruments such as dishonour of cheque/ECS or any other electronic or clearing mandate given by the customers/borrowers.

and which were collected by the appellants during the disputed period i.e., from July, 2012 to March, 2016, and whether the appellants are providing a declared service in terms of Section 66E(e) of the Finance Act, 1994 read with Section 174 (2) CGST Act, 2017.

7. On perusal of the records of the case, it transpires that during an audit conducted on the records of the appellants, the agreements entered by the appellants with their customers/borrowers were examined and the audit wing of the department had identified non-payment of service tax, both (i) on penal interest/penal charges collected in case of default/delay in payment of EMI and (ii) on charges recovered for bouncing/dishonour of the repayment instruments, cheque, ECS or other electronic or clearing mandate, in respect of loans and advances given to their customers/borrowers. The Department has interpreted that, as per Section 66B which was introduced with effect from 01.07.2012, read with Section 65B(44) of the Finance Act, 1994, '*any activity carried on*' by '*a person for another for consideration',* will be levied to

service tax, unless otherwise excluded or covered by the negative list of services. On the basis of various clauses in the agreement entered into by the appellants with their customers/borrowers, the Department alleged that recovery/earning of an extra/surplus (i.e., penal interest/penalty) being other than the loan amount and the principal interest is nothing but a compensation received by the appellants on account of delay in payment of EMI by the customer. As these charges are not in the nature of principal interest and are to be appropriately treated as consideration for a declared service of 'tolerating an act' of non-payment/delay in payment of EMI by the customers/borrowers, as per clauses made in the loan agreement entered into by the appellants in providing loans and advances, show cause proceedings were initiated vide SCN dated 15.12.2018. The learned Commissioner had examined certain clauses providing for 'Remedies in case of default', 'terms of loan' and 'definitions/abbreviations' in the various agreements such general Loan agreement, Auto-Loan agreement and personal loan & cross sell agreement and had given a finding that the agreements do not support the contention that these charges are interest on delayed payments; and that the intention of both the parties is to avoid litigation by paying a pre-determined sum to the lender on breach of contract by the borrower. Thus, he concluded that these penal charges and bounce charges paid by the borrower for default in payment of EMI/dishonour of payment instrument is a consideration and such a default/delay/non-payment/dishonour of payment instrument is tolerated by the appellants on payment of an amount as agreed upon in the agreement and it is a declared service of 'agreeing to tolerate an act or a situation' under section 66 E(e) of the Finance Act, 1994. Accordingly, he ordered that penal Charges and bounce charges paid by borrowers is a consideration for service rendered by the appellants and service tax is thus payable on such consideration by confirming the adjudged demands. The decision taken by the learned Commissioner in the impugned order dated 07.09.2018 is as follows:

> "*Para 21. In view of the above discussions and findings, I pass the following order –*
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> ***ORDER***
>
> *a) I hold that activity of M/s Bajaj Finance Limited of tolerating the act of 'default and non-payment and late payment in payment of EMI by the Borrowers & Customers and dishonor of payment instrument given by the Borrowers and Customers towards repayment of loan installments' is considered as 'Declared service' of 'agreeing to tolerate an act or situation' in terms of Section 66(E)(e) of the Finance Act, 1994 read with Section 65B(22) of the*

Act and thereby "Service" in terms of Section 65B(44) of the Finance Act, 1994 and 'taxable service' in terms of Section 65(51) of the Finance Act, 1994 and penal and bounce charges paid by the Borrowers and Customers in lieu is the consideration for the services rendered as above;

b) I confirm the Show Cause Notice No. Show Cause Notice SCN No.07/R-I/DN-V/GST-I/AUDIT-I/COMMR/2017-18 issued F. No. V (ST)15-17/Commr/Audit-I/17-18 dated 15.01.2018 and determine the demand of Service Tax amounting to ***Rs.53,87,14,050/- [Rupees Fifth three crores eighty seven lakhs fourteen thousand and fifty only]****, not paid by M/s Bajaj Finance Limited on the peal and bounce charges received from the Customers and Borrowers during the period from 01.07.2012 to March 2016, under the provisions of Section 73(2) of the Finance Act, 1994.*

c) I confirm the demand of interest on the amount of Service tax confirmed as detailed in Sr. No.(b) above, as the applicable rates, and order recovery of the same from M/s Bajaj Finance Limited, under the provisions of Section 75 of Finance Act, 1994.

d) I also impose a penalty of ***Rs.53,87,14,050/- [Rupees Fifth three crores eighty seven lakhs fourteen thousand and fifty only]****, on M/s Bajaj Finance Limited, Pune, under the provisions of Section 78(1) of the Finance Act, 1994.*

e) However, I give an option to M/s Bajaj Finance Limited, under clause (ii) of first proviso and also second proviso to Section 78(1) of the Finance Act, 1994, as amended, to pay 25% of the service tax determined and confirmed at Sr. No. (b) above as penalty, provided M/s Bajaj Finance Limited pays the entire amount of Service Tax, as determined /confirmed in Sr. No.(b) above, along with interest payable thereon as ordered in Sr. No. (c) above as well as the reduced 25% penalty, within 30 days of the date of communication of this order.

f) I impose penalty of ***Rs.10,000/- (Rupees Ten Thousand only)*** *on M/s Bajaj Finance Limited, Pune, under the provisions of Section77(1)(e) of the Finance Act, 1994 for their failure to issue and account for invoices, in respect of Penal and Bounce charges recovered in their books of account in the manner prescribed as per Rule 4A of the Service Tax Rules, 1994 as discussed in Para 19.3 supra.*

g) I refrain from imposing Penalty under the provisions of Section 77(1)(a) of the Finance Act, 1994 for the reasons discussed in Para 19.2 supra."

8. In order to examine the issues before us, we would like refer to certain words, phrases that have been explained under section 65Bibid,for the purpose of interpretation under the service tax statue i.e., Finance Act, 1994. The relevant words and legal provisions referred in the case before us are extracted below:

"65B. Interpretations. *— In this Chapter, unless the context otherwise requires, —*

(22) "declared service" means any activity carried out by a person for another person for consideration and declared as such under section 66E;

xx xx xx xx xx

(30) "interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) but does not include any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized;

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(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

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(51) "taxable service" means any service on which service tax is leviable under section 66B;

***66B. Charge of service tax on and after Finance Act, 2012**. — There shall be levied a tax (hereinafter referred to as the service tax) at the rate of fourteen percent. 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.*

***66D. Negative list of services.** —The negative list shall comprise of the following services, namely: —*

(a) services by Government or a local authority excluding the following services to the extent they are not covered elsewhere—

(i) services by the Department of Posts by way of speed post, express parcel post, life insurance and agency services provided to a person other than Government;

(ii) services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport;

(iii) transport of goods or passengers; or

(iv) support services, other than services covered under clauses (i) to (iii) above, provided to business entities;

(b) services by the Reserve Bank of India;

(c) services by a foreign diplomatic mission located in India;

(d) services relating to agriculture or agricultural produce by way of—

(i) agricultural operations directly related to production of any agricultural produce including cultivation, harvesting, threshing, plant protection or seed testing;

(ii) supply of farm labour;

(iii) processes carried out at an agricultural farm including tending, pruning, cutting, harvesting, drying, cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging and such like operations which do not alter the essential characteristics of agricultural produce but make it only marketable for the primary market;

(iv) renting or leasing of agro machinery or vacant land with or without a structure incidental to its use;

(v) loading, unloading, packing, storage or warehousing of agricultural produce;

(vi) agricultural extension services;

(vii) services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce;

(e) trading of goods;

(f) any process amounting to manufacture or production of goods;

(g) selling of space or time slots for advertisements other than advertisements broadcast by radio or television;

(h) service by way of access to a road or a bridge on payment of toll charges;

(i) betting, gambling or lottery;

(j) admission to entertainment events or access to amusement facilities;

(k) transmission or distribution of electricity by an electricity transmission or distribution utility;

(l) services by way of—

(i) pre-school education and education up to higher secondary school or equivalent;

(ii) education as a part of a curriculum for obtaining a qualification recognised by any law for the time being in force;

(iii) education as a part of an approved vocational education course;

(m) services by way of renting of residential dwelling for use as residence;

(n) services by way of—

(i) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount;

(ii) inter se sale or purchase of foreign currency amongst banks or authorised dealers of foreign exchange or amongst banks and such dealers;

(o) service of transportation of passengers, with or without accompanied belongings, by—

(i) a stage carriage;

(ii) railways in a class other than—

(A) first class; or

(B) an air conditioned coach;

(iii) metro, monorail or tramway;

(iv) inland waterways;

(v) public transport, other than predominantly for tourism purpose, in a vessel between places located in India; and

(vi) metered cabs, radio taxis or auto rickshaws;

(p) services by way of transportation of goods—

(i) by road except the services of—

(A) a goods transportation agency; or

(B) a courier agency;

(ii) by an aircraft or a vessel from a place outside India up to the customs station of clearance in India; or

(iii) by inland waterways;

(q) funeral, burial, crematorium or mortuary services including transportation of the deceased.

66E. Declared services. *— The following shall constitute declared services, namely: —*

(a) renting of immovable property

xx xx xx xx xx

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

9. From the perusal of the case records it transpires that the appellants are engaged in the business of financing including lending of loans and advances. As a consideration for lending/financing, the appellants charge interest from their customers/ borrowers at a particular rate, for the period for which such loan is taken. The principal and interest amount on such loan is repaid by customers/borrowers by way of EMI over a period of loan tenure. Accordingly, while computing the EMI, the appellants charges pro-rata interest payable on each due date, on the underlying assumption that the customers/borrowers would not default in payment of the EMI on the due dates. However, in case of any default, the appellants charge them an additional interest in the form of penal interest for the number of days of default. In any case of loan arrangement for lending money, the agreement between the parties i.e., lender and borrower provide for repayment of outstanding loan amount and the interest thereon in the form of Equated Monthly Installments, payable on a pre-determined date, over the entire loan tenure/repayment period. Considering the nature of the principal interest on the loan due over the entire loan tenure, collected in the form of EMI comprising of principal amount plus interest, in our considered opinion this principal interest could be treated as consideration for the usage or retention of money lent by the appellants to their customers/borrowers as per the agreement and EMIs in force. In a case where the borrower is unable to repay a particular EMI on the due date, penal interest is charged on the period of delay or additional time taken for repayment of EMI, beyond the due date. Therefore, in our considered opinion such penal interest also represents the consideration for usage or retention of money lent beyond the agreed time for payment in the form of due date of EMI. In other words, both the principal interest and the penal interest represent the time value of money. While the former indicates the interest in

the form of cost for agreed periodical repayments in the form of EMI period/due dates, the later represent the cost for period of delay or additional time taken for repayment of EMI, beyond the due date. Thus, we find that both the principal interest and penal interest is covered under the scope of the term "interest" under Section 65B(30) ibid.

10.1. In the context of the above issues under dispute, we note that the banking and monetary policy framework are being designed by the Reserve Bank of India (RBI) in exercise of the powers vested with it under the Reserve Bank of India Act, 1934 and various policy circulars in this regard are being issued from time to time by RBI. Accordingly, all banks/ banking company dealing with banking business are required to charge interest on loans / advances / cash credits / overdrafts or any other financial accommodation granted / provided / renewed by them or discount usance bills in accordance with the directives on interest rates on advances issued by Reserve Bank of India from time to time. The Master Circular issued by RBI in this regard vide RBI/2010-11/72 DBOD.No.Dir.BC.9 /13.03.00/2010-11 dated 01.07.2010 deals, *inter-alia*, with the issue of penal interest, as follows:

"***2. Guidelines***

2.1. General

2.1.1. Banks should charge interest on loans / advances / cash credits / overdrafts or any other financial accommodation granted / provided / renewed by them or discount usance bills in accordance with the directives on interest rates on advances issued by Reserve Bank of India from time to time.

xx xx xx xx xx

2.5. Levying of penal rates of interest

Banks are permitted to formulate a transparent policy for charging penal interest with the approval of their Board of Directors. However, in the case of loans to borrowers under priority sector, no penal interest should be charged for loans up to Rs.25,000. Penal interest can be levied for reasons such as default in repayment, non submission of financial statements, etc. However, the policy on penal interest should be governed by well-accepted principles of transparency, fairness, incentive to service the debt and due regard to genuine difficulties of customers."

Thus, we find that the guidelines of RBI which provide for charging interest on loans and advances also provide for levy of penal interest for default in repayment or non-submission of instruments of repayment of loan in time. The appellants being a Non-Banking Financial Institution governed by the regulatory frame work of RBI had followed the guidelines and hence there is no extra consideration that flows in such payments made on account of penal interest/delayed payment charges.

10.2. We further find that clause (iv) to sub-rule 2 to Rule 6 of the Service Tax (Determination of Value) Rules, 2006, notified vide Notification No.24/ 2012 - S.T. dated 06.06.2012, *inter alia*, provide that the value of any taxable service does not include, *'(iv) interest on delayed payment of any consideration for the provision of services or sale of property, whether movable or immovable*'. Thus, in our considered opinion the above entry clearly provide the Government had excluded the interest on delayed payment from the scope of payment of service tax.

11.1. In the impugned order, the learned Commissioner had held that penal charges and bounce charges are in the nature of consideration for having agreed to tolerate an act or a situation and thus it is a declared service of 'agreeing to tolerate an act or a situation' under section 66 E(e) of the Finance Act, 1994.

11.2 We find that the issue regarding charging of penal interest in respect of delay in payment of EMI, had been examined by the Ministry of Finance in the context of applicability of GST and it was clarified vide CBIC Circular No. 102/21/2019-GST dated 28.06.2019, that the transaction of levy of additional/penal interest does not fall within the ambit of entry 5(e) of Schedule II of the CGST Act i.e. "*agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act*", as this levy of additional/penal interest satisfies the definition of 'interest' as contained in Notification No.12/2017-Central Tax (Rate) dated 28.06.2017. Accordingly, it was clarified that 'penal interest' charged on a transaction would not be subject to GST. The said circular is extracted below:

"Circular No. 102/21/2019-GST
F. No. CBEC- 20/16/04/2018 – GST
Government of India
Ministry of Finance
Department of Revenue
Central Board of Indirect Taxes and Customs
GST Policy Wing
****
New Delhi, Dated the 28th June, 2019

To,
The Principal Chief Commissioners / Chief Commissioners / Principal Commissioners / Commissioners of Central Tax (All)
The Principal Director Generals / Director Generals (All)

Madam/Sir,

Subject: Clarification regarding applicability of GST on additional / penal interest – reg.

Various representations have been received from the trade and industry regarding applicability of GST on delayed payment charges in case of late payment of Equated Monthly Instalments (EMI). An EMI is a fixed amount paid by a borrower to a lender at a specified date every calendar month. EMIs are used to pay off both interest and principal every month, so that over a specified period, the loan is fully paid off along with interest. In cases where the EMI is not paid at the scheduled time, there is a levy of additional / penal interest on account of delay in payment of EMI.

2. Doubts have been raised regarding the applicability of GST on additional / penal interest on the overdue loan i.e. whether it would be exempt from GST in terms of Sl. No. 27 of notification No. 12/2017-Central Tax (Rate) dated 28th June 2017 or such penal interest would be treated as consideration for liquidated damages [amounting to a separate taxable supply of services under GST covered under entry 5(e) of Schedule II of the Central Goods and Services Tax Act, 2017 (hereinafter referred to as the CGST Act) i.e. "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act"]. In order to ensure uniformity in the implementation of the provisions of the law, the Board, in exercise of its powers conferred by section 168 (1) of the CGST Act, hereby issues the following clarification.

3. Generally, following two transaction options involving EMI are prevalent in the trade:-

> *Case – 1: X sells a mobile phone to Y. The cost of mobile phone is Rs 40,000/-.• However, X gives Y an option to pay in installments, Rs 11,000/- every month before 10th day of the following month, over next four months (Rs 11,000/- *4 = Rs. 44,000/-). Further, as per the contract, if there is any delay in payment by Y beyond the scheduled date, Y would be liable to pay additional / penal interest amounting to Rs. 500/- per month for the delay. In some instances, X is charging Y Rs. 40,000/- for the mobile and is separately issuing another invoice for providing the services of extending loans to Y, the consideration for which is the interest of 2.5% per month and an additional / penal interest amounting to Rs. 500/- per month for each delay in payment.*
>
> *Case – 2: X sells a mobile phone to Y. The cost of mobile phone is Rs 40,000/-. Y has the option to avail a loan at interest of 2.5% per month for purchasing the mobile from M/s ABC Ltd. The terms of the loan from M/s ABC Ltd. allows Y a period of four months to repay the loan and an additional / penal interest @ 1.25% per month for any delay in payment.*

4. As per the provisions of sub-clause (d) of sub-section (2) of section 15 of the CGST Act, the value of supply shall include "interest or late fee or penalty for delayed payment of any consideration for any supply". Further in terms of Sl. No. 27 of notification No. 12/2017- Central Tax (Rate) dated the 28.06.2017 "services by way of (a) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services)"is exempted. Further, as per clause 2 (zk) of the notification No. 12/2017-Central Tax (Rate) dated the 28th June, 2017, "'interest' means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) but does not include any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised;".

5. Accordingly, based on the above provisions, the applicability of GST in both cases listed in para 3 above would be as follows:

Case 1: As per the provisions of sub-clause (d) of sub-section (2) of section 15 of the CGST Act, the amount of penal interest is to be included in the value of supply. The transaction between X and Y is for supply of taxable goods i.e. mobile phone. Accordingly, the penal interest would be taxable as it would be included in the value of the mobile, irrespective of the manner of invoicing.

Case 2: The additional / penal interest is charged for a transaction between Y and M/s ABC Ltd., and the same is getting covered under Sl. No. 27 of notification No. 12/2017-Central Tax (Rate) dated 28.06.2017. Accordingly, in this case the 'penal interest' charged thereon on a transaction between Y and M/s ABC Ltd. would not be subject to GST, as the same would not be covered under notification No. 12/2017-Central Tax (Rate) dated 28.06.2017. The value of supply of mobile by X to Y would be Rs. 40,000/- for the purpose of levy of GST.

6. It is further clarified that the transaction of levy of additional / penal interest does not fall within the ambit of entry 5(e) of Schedule II of the CGST Act i.e. "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act", as this levy of additional / penal interest satisfies the definition of "interest" as contained in notification No. 12/2017- Central Tax (Rate) dated 28.06.2017. It is further clarified that any service fee/charge or any other charges that are levied by M/s ABC Ltd. in respect of the transaction related to extending deposits, loans or advances does not qualify to be interest as defined in notification No. 12/2017- Central Tax (Rate) dated 28.06.2017, and accordingly will not be exempt.

7. It is requested that suitable trade notices may be issued to publicize the contents of this circular.

8. Difficulty, if any, in the implementation of this circular may be brought to the notice of the Board immediately. Hindi version follows."

12. We also find that the issue of penal charges in respect of delay in payment amounting to declared service as contemplated by the department under section 66E(e) of the Finance Act, on which service became taxable w.e.f. July 1, 2012, has already been decided by Principal Bench of this Tribunal in the case of *M/s. South Eastern Coalfields Ltd. Vs. Commissioner of Central Excise and Service Tax in Final Order No. 51651/2020 dated 22.12.2020*. In this case, the Tribunal had held that 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. Hence, it was held by the Tribunal that it is not possible to sustain the view 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. The relevant paragraphs in the above order of the Tribunal are extracted below:

> *"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.

xx xx xx xx xx

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.

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.

44. The impugned order dated December 18, 2018 passed by the Commissioner, therefore, cannot be sustained and is set aside. The appeal is, accordingly, allowed."

The aforesaid order of the Principal Bench of the Tribunal was appealed by the department before the Hon'ble Supreme Court in Civil Appeal No.2372/2021 and the Hon'ble Apex Court dismissed the same as withdrawn. The said Order dated 11.9.2023 is extracted below:

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 2372 OF 2021

COMMISSIONER OF CENTRAL EXCISE AND SERVICE TAX — **APPELLANT(S)**

VERSUS

SOUTH EASTERN COALFIELDS LTD. — **RESPONDENT(S)**

WITH

Diary No. 24419/2022

AND

CIVIL APPEAL NOS.51-53 OF 2022

O R D E R

Learned Additional Solicitor General appearing for the appellant(s) submitted that he has instructions to withdraw these appeals. His submission is placed on record.

The Civil Appeals are dismissed as withdrawn.

.....J.
[B.V. NAGARATHNA]

.....
[PRASHANT KUMAR MISHRA]

NEW DELHI
JULY 11, 2023

13. We also find that the question 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 was examined by the CBEC and they had issued certain guidelines to the field formations clarifying the legal position for determining whether tax on an activity can be imposed, in its Circular No.178/10/2022-Service Tax dated 03.08.2022. The relevant portion of the above circular dealing with 'cheque dishonor fine/penalty' is extracted below:

> *"**Cheque dishonor fine/ penalty***
>
> *7.3 No supplier wants a cheque given to him to be dishonoured. It entails extra administrative cost to him and disruption of his routine activities and cash flow. The promise made by any supplier of goods or services is to make supply against payment within an agreed time (including the agreed permissible time with late payment) through a valid instrument. There is never an implied or express offer or willingness on part of the supplier that he would tolerate deposit of an invalid, fake or unworthy instrument of payment against consideration in the form of cheque dishonour fine or penalty. The fine or penalty that the supplier or a banker imposes, for dishonour of a cheque, is a penalty imposed not for tolerating the act or situation but a fine, or penalty imposed for not tolerating, penalizing and thereby deterring and discouraging such an act or situation. Therefore, cheque dishonor fine or penalty is not a consideration for any service and not taxable."*

14. We further find that the issue of liability of service tax on the 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" under clause (e) of Section 66E of the Finance Act, 1994 was clarified by the CBEC in its Circular No.214/1/2023-Service Tax dated 28.02.2023, in the context of the orders passed by this Tribunal in various cases. Accordingly, it was clarified that there should be a flow of consideration for this activity of tolerating an act or a situation. It was also decided by the Board not to pursue the Civil Appeals filed before the Apex Court in those cases, where the Tribunal had ordered for setting aside the orders of lower authorities for confirming the service tax demands under Section 66E(e). The relevant paragraph of the said circular is extracted below:

> *"3. 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 is similar in GST. "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 II of the CGST Act, 2017.*
>
> *4. As can be seen, the said expression has three limbs: - i) Agreeing to the obligation to refrain from an act, ii) Agreeing to the obligation to tolerate an act or a situation, iii) Agreeing to the obligation to do an act. 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. Such contractual arrangement must be an independent arrangement in its own right. 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.

5. The issue also came up in the CESTAT in Appeal No. ST/ 50080 of 2019 in the case of M/s Dy. GM (Finance) Bharat Heavy Electricals Ltd in which the Hon'ble Tribunal relied on the judgement of divisional bench in case of M/s South Eastern Coal Fields Ltd Vs. CCE Raipur {2021(55) G.S.T.L 549(Tri-Del)}. Board has decided not to file appeal against the CESTAT order ST/A/50879/2022-CU[DB] dated 20.09.2022 in this case and also against Order A/85713/2022 dated 12.8.2022 in case of M/s Western Coalfields Ltd. Further, Board has decided not to pursue the Civil Appeals filed before the Apex Court in M/s South Eastern Coalfields Ltd. supra (CA No. 2372/2021), M/s Paradip Port Trust (Dy. No. 24419/2022 dated 08-08-2022), and M/s Neyveli Lignite Corporation Ltd (CA No. 0051-0053/2022) on this ground.

6. In view of above, it is clarified that the activities contemplated under section 66E(e), i.e. when one party agrees to refrain from an act, or to tolerate an act or a situation, or to do an act, are the activities where the agreement specifically refers to such an activity and there is a flow of consideration for this activity. Field formations are advised that while taxability in each case shall depend on facts of the case, the guidelines discussed above and jurisprudence that has evolved over time, may be followed in determining whether service tax on an activity or transaction needs to be levied treating it as service by way of agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act. Contents of Circular No. 178/10/2022-GST dated 3rd August, 2022, may also be referred to in this regard.

7. Difficulty experienced, if any, in implementing the circular should be brought to the notice of the Board. Hindi version will follow."

15. We also note that demand of service tax in respect of the amount collected on account of bouncing of cheques, the issue has already been decided by the Principal Bench of this Tribunal in the case of *M/s. Rohan Motors Ltd. Vs. Commissioner of Central Excise, Dehradun in Final Order No. 51620/2020 dated 05.10.2020 reported in 2021 (45) G.S.T.L. 315 (Tri. - Del.)* holding that these charges are penal in nature and thus are not towards consideration for any service.

"19. *The demand of service tax in respect of the amount collected on account of bouncing of cheques and cancellation of orders is also not sustainable. These amount are penal in nature and not towards consideration for any service. In this connection reliance can be placed on the decisions of the Tribunal in Jaipur Jewellery Show v. C.C.E & S.T., Jaipur - 2016 (12) TMI 344 - CESTAT New Delhi = 2017 (49) S.T.R. 313 (Tribunal) and K.N. Food Industries (P.) Ltd. v. Commissioner of CGST & Central Excise, Kanpur - 2019-TIOL-3651-CESTAT-ALL = 2020 (38) G.S.T.L. 60 (Tri. - All.).*

xx xx xx xx xx

21. *The Learned Authorized Representative of the Department has, however, placed reliance upon a ruling dated March, 2019 of the Appellate Authority for Advance Ruling Maharashtra to contend that the amount collected towards bouncing of cheque charges amounts to supply of service, but Learned Counsel for the appellant has pointed out that the said order was rectified subsequently by the Appellate Authority for Advance Ruling Maharashtra in its order dated December 12, 2019 [2020 (41) G.S.T.L. 651 (App. A.A.R. GST - Mah.)] and it was held.*

"We hereby hold that the additional/Penal interest recovered by the Applicant from their customers against the delayed payment of monthly instalments of the load extended to such customers, would be exempt from GST in terms of Sl. 27 of the Notification No. 12/2017-C.T. (Rate), dated 28-6-2017."

22. *Thus, for all the reasons stated above, it is not possible to sustain the impugned order dated June 18, 2015 passed by Commissioner. It is, accordingly, set aside and the appeal is allowed.**"***

16. In view of the above discussions and findings recorded in the preceding paragraphs, as well as on the basis of decisions of the Tribunal and higher judicial forum, we are of the considered view that the impugned order holding that penal interest and bouncing charges received by the appellants as "consideration" for "tolerating an act", and are leviable to service tax under section 66E(e) of the Finance Act, 1994, cannot be sustained.

17. In view of the above, the appeals filed by the appellants are allowed by setting aside the impugned order dated 24th August, 2018.

(Order pronounced in the open court on 07.08.2023)

(S.K. Mohanty)
Member (Judicial)

(M. M. Parthiban)
Member (Technical)

Sinha