MAHARASHTRA AUTHORITY FOR ADVANCE RULING

(constituted under section 96 of the Maharashtra Goods and Services Tax Act, 2017)

BEFORE THE BENCH OF

(1) Shri B. V. Borhade, Joint Commissioner of State Tax
(2) Shri Pankaj Kumar, Joint Commissioner of Central Tax

GSTIN Number, if any/ User-id		27AABCB1518L1ZS
Legal Name of Applicant		Bajaj Finance Limited
Registered Address/Address provided while obtaining user id		3rd Floor, Panchshil Tech Park, Viman Nagar, Pune-411 014
Details of application		GST-ARA, Application No. 21 Dated 09.05.2018
Concerned officer		State Tax Officer (VAT-C-707) Pune
Nature of activity(s) (proposed / present) in respect of which advance ruling sought		
A	Category	Service Provision
B	Description (in brief)	• The Applicant is a non-banking financial institute and is inter alia engaged in providing various types of loan to the customers such as auto loans, loan against the property, personal loan, consumer durable goods loan, etc. • The loan agreements entered into by the Applicant with its borrowers/customers, inter alia provide for repayment of the outstanding dues/Equated Monthly Installments (EMI) through cheque/ Electronic Clearing System (ECS)/ National Automated Clearing House (NACH') or any other electronic or clearing mandate, on the due dates stipulated in the agreement. • In case of dishonor of cheque /ECS/NACH or any other electronic or clearing mandate, the Applicant imposes Penal Charges/ Bounce Charges (hereinafter collectively referred to as **'Bounce Charges'**) on the customers.
Issue/s on which advance ruling required		(vii) whether any particular thing done by the applicant with respect to any goods and/or services or both amounts to or results in a supply of goods and/or services or both, within the meaning of that term
Question(s) on which advance ruling is required		As reproduced in para 02 of the Proceedings below.

PROCEEDINGS

(under section 98 of the Central Goods and Services Tax Act, 2017 and the Maharashtra Goods and Services Tax Act, 2017)

The present application has been filed under section 97 of the Central Goods and Services Tax Act, 2017 and the Maharashtra Goods and Services Tax Act, 2017 [hereinafter referred to as "the CGST Act and MGST Act"] by Bajaj Finance Limited, the applicant, seeking an advance ruling in respect of the following question :

Whether the Bounce Charges collected by the Applicant should be treated as a supply under the GST regime?

At the outset, we would like to make it clear that the provisions of both the CGST Act and the MGST Act are the same except for certain provisions. Therefore, unless a mention is specifically made to such dissimilar provisions, a reference to the CGST Act would also mean a reference to the same provision under the MGST Act. Further to the earlier, henceforth for the purposes of this Advance Ruling, a reference to such a similar provision under the CGST Act / MGST Act would be mentioned as being under the "GST Act".

02. **FACTS AND CONTENTION - AS PER THE APPLICANT**

The submissions, as reproduced verbatim, could be seen thus-

1. The Applicant is a non-banking financial company and is inter alia engaged in providing various types of loan to the customers such as auto loans, loans against the property, personal loans, consumer durable goods loans, etc. All these loans are interest bearing loans.

2. The Applicant inter alia enters into agreements with borrower/customers for providing loans to them. The loan agreements provide for repayment of the outstanding dues/Equated Monthly Installments (EMI) through cheque/ Electronic Clearing System ("ECS")/ National Automated Clearing House ("NACH") or any other electronic or clearing mandate. The illustrative copies of loan agreement entered into between the Applicant and the customers are collectively enclosed **as Annexure-1.**

3. In case of dishonour of cheque/ECS/NACH or any other electronic or clearing mandate by the customers, the Applicant collects penal/bounce charges, which is in line with the agreed terms and conditions. The bounce charges are generally a fixed amount per default committed by the customer, for e.g. Rs.350/- for each dishonour of cheque/ECS.

4. The relevant extract of clauses of a sample auto loan agreement in respect of bounce charges is reproduced below for ease of reference:

> *"1. DEFINITIONS AND ABBREVIATIONS:*
> *x. "Bounce Charges" shall mean, dishonor of post-dated cheque/ ECS ADM/ entrusted by the borrower/co applicant/co borrower for clearance of EMI (monthly installments) or non-payment of installment on or before respective due date for other modes.*
> *II. TERMS OF THE LOAN:*
> *3. The Borrower agrees and confirms that:*
> *(iv) BFL is entitled to levy penalty as follows on default:*
> *(a) Bounce Charges of up to Rs.350/- on each Bounce as per clause B of the schedule.*
> ..... Emphasis Supplied

5. The amount of bounce charges collected from the customers are accounted by the Applicant in its core accounting platform i.e. SAP under General Ledger Code 60000150.

Under the GST (implemented from July 01, 2017), the Applicant is of the view that bounce charges collected from the customers (for the breach of the terms and conditions of the loan) are in the nature of penalty/ liquidated damages and therefore, the same is not a consideration for supply of service and hence, not be subjected to GST levy. However, given the ambiguity on taxability of penal/ bounce charges under the GST law, as an abundant caution, the Applicant is filing the present application for Advance Ruling.

Statement containing the Applicant's interpretation of law and/or facts, as the case may be, in respect of Question(s) on which Advance Ruling is sought.

2. **Question requiring advance ruling**

2.1. This advance ruling is sought to ascertain whether the Bounce Charges collected by the Applicant should be treated as a supply under the GST Regime?

3. **Applicant's Interpretation**

3.1 In this context, the Applicant has analyzed the relevant legal provisions in the ensuing paras.

A. Bounce Charges do not fall within the ambit of 'supply under the GST regime

A.1 Under the GST regime, the taxable event shall be the supply of goods or services. The scope of the term 'supply' is provided under Section 7 of the CGST Act, which includes all forms of supply of goods and/or services such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration in the course or furtherance of business and importation of services. It also includes activities specified in Schedule I made or agreed to be made without a consideration. The said Section 7 is reproduced herein below for reference:

> *"7 (1) For the purposes of this Act, the expression "supply" includes*
> *(a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;*
> *(b) import of services for a consideration whether or not in the course or furtherance of business;*
> *(c) the activities specified in Schedule I, made or agreed to be made without a consideration, and*
> *(d) the activities to be treated as supply of goods or supply of services as referred to in Schedule II."*
> ..... Emphasis Supplied

A.2 In view of the above provision, any activity undertaken without consideration, except those covered under Sch. I, shall not be treated as 'supply', and accordingly, will not be subject to GST levy and hence, not liable for payment of GST. Further, the Bounce Charges collected by the Applicant are not covered under the list of activities specified in Schedule I of the CGST Act. Therefore, in this case, analysis is required to know whether the penal charges collected as Bounce Charges would qualify as a consideration towards supply of service.

A.3 It is submitted that the term 'consideration is defined under Section 2 (31) the CGST Act as under:

> *(31) "consideration" in relation to the supply of goods or services or both includes*
> *(a) any payment made or to be made, whether in money or otherwise, in respect of in response to, or for the inducement of the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;*
> *(b) the monetary value of any act or forbearance, in respect of, in response to, or for the inducement of the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government."*

A.4 Since the above definition is an inclusive one, the meaning of the term 'consideration' will have to be understood from various external aids, including the natural meaning given in various dictionaries, meaning given to the term in rulings by various forums, etc.

A.5 It is submitted that the concept of consideration has been derived from the Latin phrase "quid pro quo" which means "something for something". It is a well settled principle that "where there is no consideration, there is no contract".

A.6 Reference in this regard is made to the definition of the term 'consideration provided in Section 2(d) of the Indian Contract Act, 1872 (hereinafter referred to as **'the Contract Act'**), which reads as under:

> *"**When, at the desire of the promisor**, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise."*

A.7 Furthermore, it is submitted that various dictionaries define the term 'consideration as follows:

BLACK LAW DICTIONARY

Consideration means something which is of value in the eye of law, moving from the plaintiff, either of benefit to the plaintiff or of detriment to the defendant.

WEBSTER DICTIONARY

Something of value given or done in exchange for something of value given or done by another, in order to make binding contract; inducement for a contract.

A.8 From the above discussed meaning of the term 'consideration', it can be said that consideration would necessarily mean "quid pro quo", i.e. something in return. It is a benefit which must be bargained for between the parties, and is essential reason for a party entering into a contract. Further, the consideration for an activity must be at the desire of the other person.

A.9 In the present case, the Bounce Charges are collected by the Applicant on account of failure of the borrower/customer in fulfilling its obligation to ensure that the funds were available to honour a cheque or meet a direct debit request presented by the Applicant for the loan installment. Therefore, it is submitted that the Bounce Charges are not recovered by the Applicant in lieu of, or, in return for any activity performed by the Applicant.

The Applicant would like to bring your attention to clause (d) of sub-section (1) of Section 7 of the CGST Act, which states that the expression supply also includes the activities to be treated as supply of goods or supply of services as referred to in Schedule II. Entry 5 of Schedule II specifies the list of activities to be treated as supply of services, which inter alia contains clause (e), which *reads as 'agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act.*

A.11 It is submitted in this regard that the expression to tolerate an act' used in the above clause, should be understood to cover instances where the consideration is being charged by one person in order to allow another person to undertake any particular activity. These are the cases, where it is clear at the very inception that the intention of one party is to undertake an activity and the other party shall allow the same without any hindrance. Such a contract is entered with an intention to allow the other person to carry out an activity, and not as a penalty/fine to deter such person to repeat the act in future. Even if such activity is repeated in future, there is no intention to deter the happening of the same.

A.12 The expression agreeing to tolerate an act' cannot be construed to include situations wherein liquidated damages/ penalty is charged by a party for defaults/ breach committed by other party under the contract. In fact, the very intention of such penal clauses is to create a deterrent effect and ensure that the defaults/violations are not repeated by the erring party.

A.13 It is further submitted that the word 'obligation used in Clause (e), Entry 5 of Schedule II of the CGST Act, indicates the need for the existence of the desire in the person for whom the activity is done. In other words, when the service recipient requests the service provider to tolerate an act/situation and the service provider obliges to tolerate provided a consideration is paid, then such a contractual relationship will get covered by the said clause of Schedule II of the CGST Act. In such situation, the service provider binds himself to act in a particular manner as desired by the service recipient and there is consensus ad idem between the contracting parties to this effect.

A.14 Contrary to the above, the Bounce Charges are collected only on happening of any event of default by the customers in making the payment of loan installments. It is submitted in this regard that the intention of the parties entering into loan agreement is to grant/avail loan and not to tolerate non-payment of loan dues. Therefore, it would be erroneous to assume that the party granting loan (i.e. the Applicant) are entering the loan agreement to tolerate the default of the borrowers. It is further submitted that the consideration for breach of contract, in the form of liquidated damages cannot be treated as the consideration for the contract per se. Therefore, merely because of existence of the clause of penal/bounce charges in the contract for breach of the performance of the contract, it does not mean that the parties have entered into the contract for the penal/bounce charges. It is only a deterrent for the customer/borrower not to commit default. Hence, it is submitted that there is no obligation on the Applicant to tolerate the act of the default in payment of loan installments by the customer/borrower.

A.15 Therefore, the activity of collecting penal/bounce charges does not even fall under the ambit of the deemed supply under Clause (e), Entry 5 of Schedule II of the CGST Act. Hence, the penal/bounce charges collected for the default in payment of loan installment cannot be treated as consideration for any supply, and accordingly, is not taxable under the GST regime.

B. <u>Bounce Charges are in the nature of liquidated damages/penalty</u>

B.1 It is further submitted that the penal charges collected by the Applicant by way Bounce Charges are merely in the nature of penalty/liquidated damages for default in loan repayments by the customers, which should not be subject to GST levy.

B.2 Thus, liquidated damages/penalty are merely for making good the loss suffered by a contracting party due to breach of terms of the contract by other contracting party. There is no additional benefit given under the main contract of supply of service, in return for the liquidated damages.

B.3 Attention in this regard is brought towards Section 73 of the Contract Act, which statutorily allows the Applicant to recover damages from the defaulting party in case of default or breach of terms of the contract by such party to the contract. Relevant portion of Section 73 of the said Act is extracted hereunder for ready reference:

"Section 73. Compensation of loss or damage caused by breach of contract - When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

..... Emphasis Supplied

B.4 In view of the above, it is submitted that the liquidated damages / penalty charged for breach of contract are legal consequences of the defaulting party, and therefore, the said amount shall not be treated as consideration for any activity. It is further submitted that the consideration for breach of contract, in the form of liquidated damages, cannot be treated as the consideration for the contract per se, hence, would not be taxable under the GST regime.

B.5 It is submitted that even internationally, it is a settled position that the damages received by way of compensation for termination or breach of a contract cannot be treated as a supply and therefore not subject to GST/VAT levy.

B.6 In this regard, reference is made to **GSTR 2001/4**, issued by the Australian Tax Office (ATO), explains the GST treatment of court orders and out-of-court settlements. In the said ruling at Para 73, it has been clarified that the damages are the most common form of remedy arising out of the termination or breach of contract. The damage, loss or injury, being the substance of the dispute, cannot in itself be characterized as a supply made by the aggrieved party. This is because the damage, loss or injury in itself does not constitute a supply under the provision of Australian GST.

B.7 Reference is further made to **GSTR 2003/11**, pertaining to payment on early termination of a lease of goods'. It has been clarified therein that a payment received to compensate the lessor for damage or loss flowing from early termination as a result of a default by the lessee is not consideration for a supply, even though the lessor brings the lease to an end by exercising the right to terminate the lease. The Ruling further provides that in such cases, there will be no taxable supply because a payment for genuine damages, which is not consideration for any earlier or current supply, cannot be said to be made in connection with any supply. The lessor merely exercises his right to terminate and the payment is in the nature of damages for the lessee's breach of the lease which gave rise to the lessor's right to terminate. Thus, in the above Ruling issued under Australian GST, it has been clarified that mere payment of an amount under a damages claim is not a 'supply' and hence, GST is not payable on such supplies.

B.8 Further, **GST Determination No. 200516** has been issued to answer the question as to whether a club, association, trade union, society or co-operative (referred to as "association" in the Determination) makes a supply when it imposes a non-statutory fine or penalty on a member for a breach of the association's membership rules. The said GSTD clarifies that there is no supply made by an association when it imposes a fine or penalty on its member for a breach of its membership rules, and the payment of the fine or penalty is therefore not a consideration for a supply and hence not leviable to GST. It has been clarified in the above GSTD that if the true nature of fine or penalty is a punishment and/or to act as a deterrent, it does not accord with that nature to suggest that there is a supply to the member in return for its payment.

B.9 Further, in **New Zealand case S65 (1996) 17 NZTC 7408**, the Determination stated that an association, in accepting the payment of fine or penalty, does not enter into an obligation with the particular member to tolerate the misconduct, but rather is fulfilling its obligation to all members to enforce the rules. The member does not gain rights additional to those which are already enjoyed by virtue of being a member. That is, upon payment of the fine or penalty, the member continues to enjoy the same rights and privileges and it follows that the association is required to continue to provide the benefits of membership. In this sense, it cannot be said that the association 'makes a supply where it already has a pre-existing obligation to continue to provide the benefits of membership.

B.10 In view of the above discussed rulings, the Applicant would like to submit that the very purpose of liquidated damages / penalty is to restitute or make good, the loss incurred by a person because of a default, non-compliance, etc. of the other person. Such liquidated damages/penalty may be in relation to some other supply of service or goods which would have a separate consideration and would be subject to certain terms and conditions. When such terms and conditions are not fulfilled, the defaulting party is obligated to make good the loss by paying liquidated damages. Such liquidated damages/penalty cannot itself become consideration for continuing with the main supply of service/goods by terming the same as towards tolerating the acts of the defaulting party.

B.11 It may be noted that there is a similar kind of taxability provisions or exactly same provisions under the above referred countries with respect to taxability of penal/ bounce charge and hence, the ratio laid down by the above judicial precedents should equally apply in the current fact scenario.

B.12 In view of the above, it is humbly submitted that the penal charges collected by the Applicant by way of Bounce Charges, are nothing but in the nature of liquidated damages/penalty received from the borrowers for defaults/ breach committed by them by defaulting in loan repayments.

B.13 Hence, the Bounce Charges would not be treated as a consideration for any supply, and therefore, will be outside the levy of GST.

C. **The present issue is squarely covered by the Australian GSTD 2013/1**

C.1 It is further submitted that the present issue is squarely covered by the Australian GSTD 2013/1 which holds that the payment of a 'failed payment fee' is not consideration for a supply. In para 5 of the said GSTD, it has been clarified that a 'failed payment' means a dishonored cheque or a declined direct debit request, and the 'failed payment fee' means the fee charged by the supplier to the recipient in respect of the failed payment. The relevant facts and circumstances as stated in para 2 of the said GSTD are extracted herein below:

> *2. This Determination applies where:*
>
> *• There is an attempt to make a payment for the underlying supply by way of the supplier presenting a cheque or the supplier attempting a direct debit on the recipient's bank account in accordance with the authority it has from the recipient;*
>
> - *the attempted payment is dishonoured or declined and the supplier's financial institution imposes an 'inward dishonour fee' on the supplier;*
> - *the supplier and recipient have agreed or would be taken to have agreed that in utilising direct debit or cheque payment methods the recipient will have available funds to make the payment of the initial consideration amount for the underlying supply (we accept that this would be the case in the absence of contrary arrangements between the supplier and recipient);*
> - *the supplier and the recipient have agreed that if the payment fails the recipient will be liable to pay a fee (failed payment fee'). The obligation to pay the failed payment fee may be included in the agreement or contract for the underlying supply, or in the terms of the Direct Debit Authority for a direct debit, or because the supplier's ability to charge a failed payment fee is specified by statute;*
> - *the failed payment fee arises because the recipient of the underlying supply has not fulfilled its obligation to ensure funds were available to honour a cheque, or meet a direct debit request,*
> - *the recipient's failure to fulfil its payment obligations causes the supplier to incur additional costs, such as the inward dishonour fee charged by the supplier's financier, or to suffer other loss, such that the failed payment fee is characterised as compensatory for the additional costs or loss incurred, and*
> - *there is nothing in the agreement between supplier and recipient that describes the failed payment fee as part of the consideration for anything supplied by the supplier."*

.... Emphasis Supplied

C.2 It is submitted that the Bounce Charges collected by the Applicant in the present case is identical to the failed payment fee' referred to in the above GSTD, in as much as,

- there is an attempt to make a payment for the loan installment by way of the Applicant presenting a cheque or the Applicant attempting a direct debit on the borrower/customer's bank account in accordance with the ECS or NACH or any other electronic or clearing mandate obtained from the borrower/customer;
- the borrower/customer has agreed that it will have funds available to make the payment of the loan installment;
- the borrower/customer has agreed that if the payment fails, it will be liable to pay the bounce charges as per the terms of the loan agreement;
- the liability to pay bounce charges arise because the borrower/customer has failed to fulfil its obligation to ensure that the funds were available to honour a cheque, or meet a direct debit request;
- the borrower/customer's failure to fulfil its payment obligations causes the Applicant to incur additional costs, such that the bounce charges is characterised as compensation for the additional costs or loss incurred; and
- there is nothing in the agreement between Applicant and the borrower/customer that describes the bounce charges as part of the consideration for anything supplied by the Applicant.

C.3 In view of the above facts and circumstances, it is submitted that the GSTD 2013/1 holding that the failed payment fee is not a consideration for supply, shall be equally applicable to the bounce charges being collected by the Applicant in the present case.

C.4 It is therefore submitted that the Bounce Charges collected by the Applicant in the present case does not amount to consideration for any supply, in as much as it is merely compensatory in nature and does not have any connection with any supply of service. Hence, the bounce charges shall not be subjected to GST.

D. **Without prejudice to the above, penalty for delayed payment of consideration is to be included in the value of the supply in view of clause (d) of sub-section (2) of Section 15 of the CGST Act, therefore, the bounce charges levied for delayed payment of loan dues/EMI is to be included in the value of loans, and would be treated at par with interest.**

D.1 Without prejudice to the above, it is submitted that in view of clause (d) of sub-section (2) of Section 15 of the CGST Act, penalty for delayed payment of consideration for a supply would be included in the value of that supply. The said provision is extracted herein below for reference:

> *"(2) The value of supply shall include*
>
> *(d) interest or late fee or penalty for delayed payment of any consideration for any supply; and"*

D.2 In view of the above provision, the bounce charges levied for delayed payment of loan dues/EMI, being in the nature of penalty, is to be included in the value of loans, which is nothing but interest only. Therefore, the bounce charges so levied by the Applicant would be treated at par with interest, and any treatment given to the main consideration (i.e. interest) shall also be equally applicable to such amount (i.e. penalty). Hence, the bounce charges would be exempt from GST under Sr. No. 27 of Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017, Sr. No. 27 of Maharashtra State Notification No. 12/2017-State Tax (Rate) dated 29.06.2017, and Sr. No. 28 of Notification No. 9/2017-Integrated Tax (Rate) dated 28.06.2017.

Conclusion

3.2. Based on the above provisions and discussions, the Applicant is convinced that the activity of collecting the Bounce Charges do not amount to supply of services under the GST Regime and therefore would not be taxable. In any case, the bounce charges being in the nature of penalty for delayed payment of consideration would be included in the value of supply of loans and therefore, would be treated at par with interest, hence, the same shall be exempt from GST.

Additional submissions on 01.08.2018

Synopsis of submissions made in Appln. dt 09.05.2018 & during personal hearing held on 27.06.2018 & 18.07.2018.

A. Bounce Charges are in the nature of liquidated damages or penalty for breach of contract, which does not amount to consideration for any contract, and therefore, there cannot be any supply of service.

A.1. The Applicant lends money to the customers/borrowers with one of the conditions in the loan agreement that the customers/borrowers shall make timely repayment of loan installments on the due dates as per the repayment schedule, through cheque/ Electronic Clearing System ('ECS')/ National Automated Clearing House ("NACH') or any other electronic or clearing mandate.

A.2 However, in case of dishonour of cheque/ECS/NACH or any other electronic or clearing mandate due to the customers' failure to maintain funds in his account for clearance of the EMI on the due date, the Applicant collects penal/bounce charges from the defaulting customers. The bounce charges are generally a fixed amount per default committed by the customer, for e.g. Rs.350/- for each dishonour of cheque/ECS (refer page no. 31,45 of the submissions made on 09.05.2018). These Bounce Charges are in the nature of liquidated damages or penalty for the default committed by the customers.

A.3 It is submitted that upon breach of contract, the aggrieved party is entitled to claim compensation for breach of contract. Such compensation is a legal and statutory right provided under Section 73 and 74 of the Indian Contract Act, 1872, and even without any specific clause in the contract for the damages or compensation payable upon the breach of contract, the party suffering such breach has the statutory right to claim damages or compensation from the party who has broken the contract.

A.4 The provisions of Section 73 and 74 are extracted herein below for reference:

"73. Compensation for loss or damage caused by breach of contract. – When a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

74. Compensation for breach of contract where penalty stipulated for. – When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.

Explanation. – A stipulation for increased interest from the date of default may be a stipulation by way of penalty."

..... Emphasis Supplied

A.5 Both, Section 73 and 74, provide for reasonable compensation, but Section 74 contemplates that the maximum reasonable compensation may be the amount which may be named in the contract, but not more, even though, according to Sec. 73, the amount of compensation may exceed the sum named. In other words, Sec. 74 is narrower in scope and limits the compensation to the extent provided for, or stipulated in the contract.

A.6 It is submitted that the damages in Section 74 may either be in the nature of liquidated damages or penalty. If the sum stipulated in the contract is a genuine pre-estimate of damages likely to flow from the breach, it is called liquidated damages. If it is not a genuine pre-estimate of the loss, but an amount intended to secure performance of the contract, it may be penalty. The question whether a particular stipulation in a contract, is in the nature of penalty has to be determined by the Court against the background of various relevant factors, such as the character of the transaction and its special nature.

A.7 In the present case, the Applicant lends money to the customers/borrowers with one of the conditions in the loan agreement that the customers/borrowers shall make timely repayment of loan installments on the due dates. Further, the borrower is under a contractual obligation to ensure that sufficient funds are available in his account on the due dates of the EMI. However, in case, the borrower fails to maintain funds in his account on the due date, the cheque/ECS/NACH presented by the Applicant gets dishonoured, resulting into default in payment of loan installments. This is a clear case of breach of contract by the customer/borrower, and therefore, upon default in payment of the installments, the Applicant shall be entitled to receive damages in accordance with Section 73 and 74 of the Indian Contract Act, 1872.

A.8 The damages in the present case are liquidated in the loan agreement, wherein the parties agree in advance that upon dishonour of cheque/ECS/NACH, the customer/borrower shall be liable to pay a fixed amount to the Applicant as stipulated in the agreement. This amount is named in the agreement as Bounce/Penal charges. It is therefore submitted that such bounce/penal charges are clearly in the nature of liquidated

damages, in as much as they are pre-agreed amount of damages payable by the defaulting party on account of breach of the contract. However, the Court may hold such Bounce Charges to be penalty, in case the Court finds it as exorbitant or extravagant.

A.9 Therefore, in view of the above discussions, it is submitted that the Bounce Charges may either be treated as liquidated damages, or penalty, but in any case, the same shall be damages for breach of contract only.

A.10 It is submitted that payment of liquidated damages or penalty is not a consideration for any service, and therefore, bounce charges collected by the Applicant, being in the nature of liquidated damages or penalty, cannot be treated as a consideration for supply of service, as they are merely damages for the breach of contract.

A.11 It is further submitted that the stipulation for payment of damages upon breach of contract does not constitute a separate contract. It is only a part of the original contract. The payment of damages arises only on account of the primary contract, and it would be an incorrect interpretation to say that the payment is a consideration for any other contract. In the present case, there is only one contract between the Applicant and the borrower, which is the agreement for loan, for which consideration is payable by the borrower in the form of interest. The bounce charges are payable by the borrower, only upon the breach of such contract, and therefore, such payment does not constitute a second contract. Therefore, the payment of bounce charges by the borrower cannot be treated as a consideration either for the primary contract of loan, or for any other contract.

A.12 Hence, in the absence of any consideration, the bounce charges collected by Applicant in present case does not amount to a supply under Section 7 of the CGST Act, and therefore, the same shall not be leviable to GST.

B. <u>Bounce Charges collected by the Applicant for the breach of contract by the customer, is not covered under the ambit of Deemed Services under clause (e) of Entry 5 of Schedule II to the CGST Act.</u>

B.1 It is further submitted that the bounce charges shall not be covered by clause (e) of Entry 5 of Schedule II to the CGST Act, which reads as "agreeing to the obligation to refrain *from an act, or to tolerate an act or a situation, or to do an act. It is submitted that the* expression "agreeing to the obligation" is a prefix to all the three entries, viz. 'to refrain *from an act', 'to tolerate an act or a situation', and 'to do an act'. Therefore, the correct* interpretation of the law would be to read the above said clause as under:

- agreeing to the obligation to refrain from an act,
- agreeing to the obligation to tolerate an act or a situation,
- agreeing to the obligation to do an act

B.2 Therefore, to attract the above said clause, there must be an agreement to the obligation in respect of any of the above entries. In absence of any such agreement, there cannot be a service. For a valid agreement, there has to be a consideration between the promisor and the promisee. However, as submitted above, the bounce charges levied by the Applicant in the present case are merely damages for the breach of contract of loan, and are not consideration for any contract per se, and therefore, in the absence of any consideration, there can be no agreement to tolerate.

B.3 Further, the above said clause uses the word 'obligation', therefore, it is important to understand the meaning of the said term to give correct interpretation to the entry. The said term has not been defined in the Finance Act, 1994, or the Rules made thereunder, therefore, reference is being made to the meaning given to it in other Statutes, and its dictionary meaning, as under:

- ***Section 2(a) of the Specific Relief Act, 1963:***
  "Obligation" includes every duty enforceable by law.
- ***<u>Commentary on Section 2(a) of the Specific Relief Act, 1963, by Pollock & Mulla, at Pg. No. 1837 of Volume II, 14th Edition, reads as under</u>:***
  "Clause (a): Obligation
  <u>An obligation is a bond or tie, which constrains a person to do or suffer something; it implies a right in another person to which it is correlated, and it restricts the freedom of the obligee with reference to definite acts and forbearances</u>: but in order to be enforceable, it must be an obligation recognised by law; and not merely a moral, social or religious one. An obligation may not be a legal one, where it cannot be reduced to a money value; <u>legal obligation includes every duty enforceable by law so that when a legal duty is imposed on the person in respect to another, the other is invested with a corresponding legal right.</u> This definition is used in its wider juristic sense as covering duties arising ex contractu or ex delicto, and may cover any other enforceable duty under any statute.'
- ***Black's Law Dictionary:***
  "Obligation. (n.)
  1. <u>A legal or moral duty to do or not do something</u>. The word has many wide and varied meanings. It may refer to anything that a person is bound to do or forbear from doing, whether the duty is imposed by law, contract, promise, social relations, courtesy, kindness, or morality.
  2. <u>A formal, binding agreement or acknowledgement of a liability to pay a certain amount or to do a certain thing for a particular person or set of persons; esp., a duty arising by contract.</u>
  3. Civil law. A legal relationship in which one person, the obliger, is bound to render a performance in favor of another, the obligee."
- *Oxford Dictionary:*
  "obligation n.
  <u>an act or course of action to which a person is morally or legally bound</u> the condition of being so bound. 2. a debt of gratitude for a service or favour.'

..... Emphasis Supplied

B.4 In view of the above, it is submitted that the word 'obligation can be understood to be an act or course of action to which a person is morally or legally bound. It is a bond or tie, which constrains a person to do or suffer something and it implies a right in another person to which it is correlated. As defined in the Specific Relief Act, 1963, 'obligation includes every duty enforceable by law, so that when a legal duty is imposed on the person in respect to another, the other is invested with a corresponding legal right. Therefore, an obligation comes into existence, only when there is a duty or a liability on the person making the obligation, with a corresponding right to the other person to enforce such obligation.

B.5. However, in the present case, there is no obligation upon the Applicant to tolerate the act of non-payment or delayed payment by the borrower, in as much as, neither the Applicant has any duty or liability towards the borrower, nor the borrower has any right on the Applicant. The payment of bounce charges neither obligates the Applicant not to take any legal action against the borrower, nor the borrower gains any right to sue the Applicant for any legal action taken by the Applicant. On the contrary, the borrower is under the contractual obligation to make timely repayment of the loan to the Applicant, and upon the breach of such obligation, the Applicant is legally entitled to recover damages for such breach and also sue the borrower for such breach.

B.6 It is further submitted that a sum which is payable in pursuance of a contractual obligation is different from a sum payable on a breach of contractual obligation. Therefore, the bounce charges payable by the borrower on breach of its contractual obligation cannot be treated as a payment for any obligation on the Applicant towards the borrower.

B.7 In view of the above discussion, it is submitted that in the absence of an agreement by Applicant to any obligation to tolerate the act of non-payment or delayed payment of loan installments by the borrowers, the mere recovery of bounce charges for breach of the contract does not constitute a service by Applicant to the borrower.

B.8 Hence, in view of the above submissions, as bounce charges is not a consideration for any supply, no GST shall be levied on such bounce charges.

C. **Even internationally, the damages for breach of contract are not taxed.**

C.1 It is further submitted that internationally, the damages received by way of compensation for termination or breach of a contract are not treated as a supply and therefore not subjected to GST/VAT levy.

C.2 In Australian Law, the GST is levied on supply under 'A New Tax System (Goods and Services Tax) Act, 1999'. The term "supply' is defined under Section 9(10) of the said Act. Clause (g) of sub-section (2) is pari materia the provisions of clause (e) of Entry 5 of Schedule II to the CGST Act, which reads as under;

> ***"9-10 Meaning of Supply***
> *(1) A supply is any form of supply whatsoever.*
> *(2) Without limiting subsection (1), supply includes any of these:*
> .....
> *(g) an entry into, or release from, an obligation:*
> *(i) to do anything; or*
> *(ii) to refrain from an act; or*
> *(iii) to tolerate an act or situation."*

C.3 In the above context, reference is made to **GSTR 2001/4**, issued by the Australian Tax Office (ATO), which explains the GST treatment of court orders and out-of-court settlements. In para 73 of the said ruling, it has been clarified that the damages are the most common form of remedy arising out of the termination or breach of contract. The damage, loss or injury, being the substance of the dispute, cannot in itself be characterized as a supply made by the aggrieved party. This is because the damage, loss or injury in itself does not constitute a supply under the provision of Australian GST.

C.4 It is pertinent to bear in mind that the definition of "supply" under the Australian GST legislation includes within its ambit "an obligation to tolerate an act". Thus, when the aforesaid GSTR namely GSTR 2001/4 states that payment of liquidated damages is not towards any supply, it is reasonable to conclude that the GSTR has also considered the clause "an obligation to tolerate an act". In other words, the GSTR impliedly concludes that the acceptance of liquidated damages does not amount to tolerating an act and hence would not fall within the ambit of "supply" for the purposes of GST.

C.5 Further, in **New Zealand case 565 (1996) 17 NZTC 7408**, the Determination stated that an association, in accepting the payment of fine or penalty, does not enter into an obligation with the particular member to tolerate the misconduct but rather is fulfilling its obligation to all members to enforce the rules. The member does not gain rights additional to those which are already enjoyed by virtue of being a member. That is, upon payment of the fine or penalty, the member continues to enjoy the same rights and privileges and it follows that the association is required to continue to provide the benefits of membership. In this sense, it cannot be said that the association makes a supply where it already has a pre-existing obligation to continue to provide the benefits of membership.

C.6 Further, in a decision of the Court of Appeal (U.K.) in case of **M/s. Vehicle Control Services Limited reported at (2013) EWCA Civ 186**, it has been observed that payment in the form of damages/penalty for parking in wrong places/wrong manner is not a consideration for service as the same arises out of breach of contract with the parking manager.

C.7 In view of above discussed rulings, it is submitted that the very purpose of liquidated damages or penalty is to restitute or make good the loss incurred by a person because of a default, non-compliance, etc., by the other person. Such liquidated damages or penalty may be in relation to some other supply of service or goods which would have separate consideration & would be subject to certain terms & conditions. When such terms

and conditions are not fulfilled, the defaulting party is obligated to make good the loss by paying liquidated damages. Such liquidated damages or penalty cannot itself become consideration for continuing with the main supply of service/ goods by terming the same as towards tolerating the acts of the defaulting party.

C.8 Thus, liquidated damages or penalty are merely for making good the loss suffered by a contracting party due to breach of terms of the contract by other contracting party. There is no additional benefit given under the main contract of supply of service, in return for the liquidated damages.

C.9 Hence, in view of the above submissions, the bounce charges levied by the Applicant cannot be treated as a supply of service, and therefore, is not liable to GST.

D. **The present issue of Bounce Charges is squarely covered by the Australian GSTD 2013/1**

D.1 It is further submitted that the present issue of Bounce Charges is squarely covered by the **Australian GSTD 2013/1** which holds that the payment of a 'failed payment fee' is not consideration for a supply. Para 5 of the said GSTD, defines the term 'failed payment' as a dishonored cheque or a declined direct debit request. Further, the term 'failed payment fee' has been defined as the fee charged by the supplier to the recipient in respect of the failed payment. Para 3 of the said GSTD states that in the circumstances described in para 2, which is reproduced herein below, the payment of a "failed payment fee' does not amount to consideration for either a financial supply or another supply (for example, a supply of administrative services):

"2. This Determination applies where:

- *There is an attempt to make a payment for the underlying supply by way of the supplier presenting a cheque or the supplier attempting a direct debit on the recipient's bank account in accordance with the authority it has from the recipient;*
- *the attempted payment is dishonoured or declined and the supplier's financial institution imposes an 'inward dishonour fee' on the supplier;*
- *the supplier and recipient have agreed or would be taken to have agreed that in utilising direct debit or cheque payment methods the recipient will have available funds to make the payment of the initial consideration amount for the underlying supply (we accept that this would be the case in the absence of contrary arrangements between the supplier and recipient);*
- *the supplier and the recipient have agreed that if the payment fails the recipient will be liable to pay a fee ('failed payment fee'). The obligation to pay the failed payment fee may be included in the agreement or contract for the underlying supply, or in the terms of the Direct Debit Authority for a direct debit, or because the supplier's ability to charge a failed payment fee is specified by statute;*
- *the failed payment fee arises because the recipient of the underlying supply has not fulfilled its obligation to ensure funds were available to honour a cheque, or meet a direct debit request;*
- *the recipient's failure to fulfil its payment obligations causes the supplier to incur additional costs, such as the inward dishonour fee charged by the supplier's financier, or to suffer other loss, such that the failed payment fee is characterised as compensatory for the additional costs or loss incurred; and*
- *there is nothing in the agreement between supplier and recipient that describes the failed payment fee as part of the consideration for anything supplied by the supplier."*

.... Emphasis Supplied

D.2 Para 21 of the above said GSTD explains the reasoning based on which it is held that the payment of 'failed payment fee' does not amount to consideration for supply. The said para is extracted herein below for reference:

"21. In the circumstances covered by this Determination, the failed payment fee does not have sufficient nexus to any supply. The following matters, in combination, are relevant to this conclusion:

(a) The failed payment fee relates to losses suffered by the supplier when the recipient fails to meet its obligations to have funds available.

(b)The failed payment fee is not an intended consequence of the underlying supply, but arises because the recipient failed to have sufficient funds available

(c)There is nothing in addition to the underlying supply that the failed payment fee could be described as "for: even within the broader definition of 'for consideration?".

.... Emphasis Supplied

D.3 It is relevant to note that the above GSTD has been issued in the context of Australian GST law, wherein the ambit of 'supply' is wide enough to cover an obligation to tolerate an act or situation, as submitted in **para C.2** above. Even in such context, the GSTD holds that the payment of "failed payment fee' does not amount to consideration for supply. The GSTD emphasises on the point that there is no additional supply which is 'for consideration; the 'failed payment fee' arises due to the failure of the borrower to meet his obligation. The "failed payment fee' is not for the service to the borrower, but is against the borrower for failing to meet his obligation. Hence, on this basis, the GSTD concludes that there is no supply arising on the payment of 'failed payment fee', and that such payment is not a consideration for any supply.

D.4 It is submitted that the Bounce Charges collected by the Applicant in the present case are identical to the "failed payment fee referred to in the above GSTD, in as much as,

- there is an attempt to make a payment for the loan installment by way of the Applicant presenting a cheque, or the Applicant attempting a direct debit on the borrower/customer's bank account in accordance with the ECS or NACH or any other electronic or clearing mandate obtained from the borrower/customer;
- the borrower/customer has agreed that it will have funds available to make the payment of the loan installment;
- the borrower/customer has agreed that if the payment fails, it will be liable to pay the bounce charges as per the terms of the loan agreement;

- the liability to pay bounce charges arise because the borrower/customer has failed to fulfill its obligation to ensure that the funds were available to honour a cheque, or meet a direct debit request;
- the borrower/customer's failure to fulfil its payment obligations causes the Applicant to incur additional costs, such that the bounce charges is characterised as compensation for the additional costs or loss incurred; and
- there is nothing in the agreement between the Applicant and the borrower/customer that describes the bounce charges as part of the consideration for anything supplied by the Applicant.

D.5 In view of the above facts and circumstances, it is submitted that the above **GSTD 2013/1** shall be squarely applicable to the bounce charges in the present case. The Bounce Charges payable by the borrower is not for any service rendered to him, but is against the borrower for the failure to meet his contractual obligation. The bounce charges are merely damages for the breach of contractual obligations, and therefore, the same do not have any connection with provision of service. Hence, the payment of bounce charges does not amount to consideration for any service.

D.6 Hence, in absence of any consideration, the bounce charges collected/levied by the Applicant shall not be subjected to GST.

E. Without prejudice to the above, Applicant being primarily engaged in the business of financing/lending, any amount recovered by the Applicant in respect of granting loans is in the nature of interest only.

E.1 Without prejudice to the above, the Applicant being primarily engaged in the business of financing/lending, any amount recovered by the Applicant in respect of granting loans is in the nature of interest only.

E.2 Hence, the bounce charges collected by the Applicant in the present case for the delayed payment of loan installments by the customer is to be treated at par with interest, and accordingly, the same shall be exempt from GST under Serial No. 27 of the Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017, read with Maharashtra State Notification No. 12/2017-State Tax (Rate) dated 29.06.2017.

F. Without prejudice to the above, penalty for delayed payment of consideration is to be included in the value of the supply in view of clause (d) of sub-section (2) of Section 15 of the CGST Act.

F.1 Without prejudice to the above, it is submitted that in view of clause (d) of sub-section (2) of Section 15 of the CGST Act, penalty for delayed payment of consideration for a supply would be included in the value of that supply. The said provision is extracted herein below for reference:

> *"15. Value of taxable supply.*
> *(2) The value of supply shall include –*
> *(d) interest or late fee or penalty for delayed payment of any consideration for any supply;"*
> ..... Emphasis Supplied

F.2 In view of the above provision, any interest or late fee or penalty charged/levied or collected for delayed payment of any consideration for a supply, shall be includible in the value of the said supply.

F.3 It is relevant to note that the said provision does not have a restricted application to "taxable supply"; the said provision is applicable for determination of value of "any supply", either taxable or exempt. Therefore, even if the main supply is exempt by way of any exemption notification, still, the provisions of Section 15(2) shall be applicable to determine the value of such exempt supply. It would be incorrect to say that the provisions of Section 15(2) are not applicable for exempt supplies, in as much as, the valuation of exempt supplies is equally important as that of taxable supplies, as the quantum of reversal of input tax credit under Section 17(2) of the CGST Act is determined on the basis of the value of exempt supplies. Hence, the provisions of Section 15(2) are applicable to determine the value of exempt supplies as well.

F.4 In view of Section 15(2)(d) of the Act, the bounce charges levied for delayed payment of loan dues/EMI, being in the nature of penalty, is to be included in the value of loans, which is nothing but interest only. Therefore, the bounce charges so levied by the Applicant would be treated at par with interest, and any treatment given to the main consideration (i.e. interest) shall also be equally applicable to such amount (i.e. penalty). Hence, the bounce charges would be exempt from GST under Serial No. 27 of the Notification No. 12/2017 Central Tax (Rate) dated 28.06.2017, read with Maharashtra State Notification No. 12/2017-State Tax (Rate) dated 29.06.2017.

G. It is submitted that the above submissions are in addition and without prejudice to the submissions made by the Applicant in its application dated 09.05.2018.

03. CONTENTION – AS PER THE CONCERNED OFFICE

Comments and submission regarding above referred application as follows.

BRIEF HISTROY:

M/S.BAJAJ FINANCE LIMITED is a Non-Banking Financial Company and inter alia engaged in providing various types of loan to the customers such as auto loans, loans against the property, personal loans, consumer durable goods loan etc. All these loans are interest bearing loans.

The applicant inter alia enters into agreements with borrower/customers for providing loans to them. The loan agreements provide for repayment of the o are equated monthly instalments(*EMI) through ECS i. e. Electronic Clearing System/NACH i.e. National Automated Clearing House/Cheque/any other electronic or clearing mandate. In case of dishonour of Cheque/ECS/NACH or any other electronic or clearing mandate by the customers, the applicant collects penal/bounce charges which is in line with the agreed terms and conditions. The bounce charges are generally a fixed amount per default committed by the customer for e.g.Rs.350/- for each dishonour of cheque/ECS for the breach of the terms and conditjons of the loan.

The amount of bounce charges collected from the customers are accounted by the Applicant in its core accounting platform i.e. SAP under General Ledger Code 60000150.

Questions asked by the applicant for advance ruling

Whether the Bounce Charges collected by the Applicant should be treated as a supply under the GST regime?

Submission and view of jurisdictional officer -

Name of Dealer : M/s. Bajaj Finance Limited
Registration No. of service tax : AABCB1518LST001
Period of Registration : Date of issue of Original ST-2: 02/11/2001 TO 30/06/2017
Registered address for service tax : 4th Floor, Unit 401 to 412,sr.no.208/1B,Bajaj House, Lohgaon,Pune-411014
Classification of service

Chapter / Section / Heading	Description of Service	CGST Rate(%)	SGST/UTGST Rate (%)	IGST Rate (%)	Condition
Heading 9997	Other services (washing, cleaning and dyeing services; beauty and physical well-being services; and other miscellaneous services including services nowhere else classified).	9	9	18	0
Section 7	**Financial and related services; real estate services; and rental and leasing services.**				
Heading 9971 (Financial and related services)	(vi) Financial and related services other than (i), (ii), (iii), (iv), and (v) above.	9	9	18	

3. Scope of Supply :

Section 7 of the Central Goods and Services Tax Act 2017 (CGST 2017) defines scope of supply.

As per Section 7(1) (d) the activities to be treated as a supply of good or supply of services as referred in the schedule 2.

As per schedule 2 para 5 clause (e) "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act"

As per above provision Bounce Charges on Non-performance of a contract is an activity or transaction which is treated as a supply of service and the Applicant is deemed to have received the consideration in the form of charges, liquidated Damages and is accordingly, required to pay tax on such amount.

2) Definitions :- 31) "Consideration" in relation to the supply of goods or services or both includes

a) any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;

3) Value of **Supply:**

As per sub-section 1 of section 15 the value of a supply of goods or services or both shall be the transaction value, which is the price actually paid or payable for the said supply of goods or services or both where the supplier and the recipient of the supply are not related and the price is the sole consideration for the supply.

As per sub-section 2 of section 15 The value of supply shall include-

a) any taxes, duties, cesses fees and charges levied under any law for the time being in force other than this Act, the Central Goods and Services Tax Act and the Goods and Services Tax (Compensation to States) Act, if charged separately by the supplier;

d) interest or late fee or penalty for delayed payment of any consideration for any supply

As per above provision Bounce Charges on Non-performance of a contract is an activity or transaction which is treated as a supply of service and the Applicant is deemed to have received the consideration in the form of charges, liquidated Damages and is accordingly, required to pay tax on such amount.

04. HEARING

The Preliminary hearing in the matter was held on 27.06.2018, Sh. Sandeep Sachdeva, Advocate along with Sh. Chaitanya Bhatt, C.A. and Sh. Arpit Chaturvedi, Advocate appeared and made contentions for admission of application as per their ARA. Sh. Sandeep Sachdeva, Advocate specifically mentioned that the same issue is pending for adjudication at Commissioner, Pune under Service Tax. Jurisdictional Officer Sh. Vinit Thite, State Tax Officer (VAT-C-707) Pune appeared and made written submissions.

The final hearing was held on 18.07.2018, Sh. Sandeep Sachdeva, Advocate along with Sh. Arpit Chaturvedi, Advocate and Sh. Ganesh Mandhane National Head Taxation appeared and made oral and written submissions. Jurisdictional Officer Sh. Vinit Thite, State Tax Officer (VAT-C-707) Pune appeared and stated that they have already made written submissions earlier.

05. **OBSERVATIONS**

We have gone through the facts of the case, submissions made by the applicant and the documents on record.

The Applicant, a non-banking financial company are providing various types of loan such as auto loans, loan against the property, personal loans, consumer durable goods loans, etc, to their customers and charge interest on such loans disbursed, for which they enter into agreements with borrower/customers. The agreements provide for repayment of the loan in the form of Equated Monthly Installments (EMI) vide cheque/Electronic Clearing System (ECS), etc. The installment of the loan is computed taking into consideration the amount of loan, duration of the loan and the amount of EMI that would be payable. The **EMI paid by the customers is a fixed amount payable at a specified date, which includes both interest and the principal amount.** In case of dishonour of cheque/ECS/NACH or any other electronic or clearing mandate by the customers, the Applicant collects bounce charges, which is in line with the agreed terms and conditions of the agreement. The 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 Applicant is of the view that such bounce charges collected, are in the nature of penalty/ liquidated damages and therefore, the same is not a consideration for supply of service and hence, not be subjected to GST levy.

While submitting that the Applicant is of the view that penal interest collected from the customer is in the nature of additional interest, and therefore, the same is not subjected to GST levy, the applicant has reproduced the relevant extract of clauses of a sample auto loan agreement in respect of penal interest which is as follows:

"The relevant extract of clauses of a sample auto loan agreement in respect of bounce charges is reproduced below for ease of reference:

I. DEFINITIONS AND ABBREVIATIONS:

r. "Bounce Charges" shall mean, dishonor of post-dated cheque/ ECS ADM/ entrusted by the borrower/co applicant/co borrower for clearance of EMI (monthly installments) or non-payment of installment on or before respective due date for other modes.

II. TERMS OF THE LOAN:

3. The Borrower agrees and confirms that:

(iv) BFL is entitled to levy penalty as follows on default:

(a) (a) Bounce Charges of up to Rs.350/- on each Bounce as per clause B of the schedule."

A perusal of the above extract reproduced by the applicant from a sample auto loan agreement and submitted by them in support of their argument that Bounce Charges, collected by them is in the nature of penalty, reveals that while drafting the agreement they themselves have defined 'Bounce Charges" as charges for dishonor of post-dated cheques, etc. Such bounce charges are collected by them from their customers for the reason that the said customers have dishonored the cheques issued by them towards payments of EMI and the applicant has tolerated the said act of their customers of dishonouring of cheques, etc.

It is therefore seen that the transaction is about the receipt by the applicant, of certain sums towards –

a. *Compensation in the form of bounce charges for dishonor of EMI cheques by their customers.*

Section 9 of the GST Act says that there shall be levied a tax on supplies of goods or services or both. So we need to understand as to whether the aforesaid receipt of bounce charges would be for a supply made by the applicant. A 'supply' defined under Section 7 of the GST Act is as follows -

"7. (1) For the purposes of this Act, the expression "supply" includes--

(a) all forms of supply of goods or services or both .....;
(b) import of services for a consideration whether or not in the course or furtherance of business;
(c) the activities specified in Schedule I, made or agreed to be made without a consideration; and .
(d) the activities to be treated as supply of goods or supply of services as referred to in Schd. II.

(2) Notwithstanding anything contained in sub-section (1),--

(a) activities or transactions specified in Schedule III; or
(b) such activities or transactions undertaken by the Central Government.....,
shall be treated neither as a supply of goods nor a supply of services.

(3) Subject to the provisions of sub-sections (1) and (2), the Government may, on the recommendations of the Council, specify, by notification, the transactions that are to be treated as –

(a) a supply of goods and not as a supply of services; or
(b) a supply of services and not as a supply of goods."

SCHEDULE I [See section 7] ACTIVITIES TO BE TREATED AS SUPPLY EVEN IF MADE WITHOUT CONSIDERATION

1. Permanent transfer or disposal of business assets where input tax credit has been availed on such assets.

2. Supply of goods or services or both between related persons or between distinct persons as specified in sec 25.....

3. Supply of goods –

(a) by a principal to his agent where the agent undertakes to supply such goods on behalf of the principal; or

(b) by an agent to his principal where the agent undertakes to receive such goods on behalf of the principal.

4. Import of services by a taxable person from a related person or from any of his other establishments outside India, in the course or furtherance of business.

SCHEDULE II [See section 7] ACTIVITIES TO BE TREATED AS SUPPLY OF GOODS OR SUPPLY OF SERVICES

1. Transfer

(a) any transfer of the title in goods is a supply of goods;
(b) any transfer of right in goods or of undivided share in goods without the transfer of title thereof, is a supply of services;
(c) any transfer of title in goods under an agreement which stipulates that property in goods shall pass at a future date upon payment of full consideration as agreed, is a supply of goods.

2. .....
3. .....
4. .....
5. Supply of services

The following shall be treated as supply of services, namely: –

(a) .....;
(b) .....;
(c) .....;
(d) .....;
(e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act; and
(f) .....
6. .....

7. .....

From the above, we find that under sub-section (1) of Section 7 states as ---

- 'Supply' as per clause (a) is for supply of goods or services or both. It is for a consideration AND has to be in the course or furtherance of business.
- 'Supply' as per clause (b) is for import of services. It is for a consideration AND may or may not be in the course or furtherance of business.
- 'Supply' as per clause (c) are the activities specified in Schedule I appended to the GST Act. It is not for a consideration. And though it has not been specifically mentioned in the clause, if we look at Schedule I, as reproduced above, the 'supply' herein would be in the course or furtherance of business.
- **'Supply' as per clause (d) is the enumeration or categorization as given in Sch. II appended to the GST Act as to which activities should be treated as supply of 'goods' & which activities to be treated as supply of 'services'. The clause does not define 'supply' but classifies the supply into either 'supply of goods' or 'supply of services'. [Clause (e) of Sch. II defines "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act" as a Supply of Services].**

Further, Sub-section (2) of section 7 states that ---

- certain, specified or notified activities shall be treated neither as a supply of goods nor a supply of services.

We also find that Sub-section (3) of section 7 states ---

- that certain activities would be notified as being -
  - (a) a supply of goods and not as a supply of services; or
  - (b) a supply of services and not as a supply of goods.

In the case before us we find that :-

- The applicant has given loans to their customers.
- The said loans were repayable by way of payment of EMI, which includes principal amount and interest.
- The EMIs are to be paid within due dates.
- In case of dishonour of cheque/ECS/NACH or any other electronic or clearing mandate by the customers, in respect of the EMIs, the Applicant collects bounce charges, which is in line with the agreed terms and conditions. The bounce charges are generally a fixed amount per default committed by the customer, for e.g. Rs.350/- for each dishonour of cheque/ECS.
- In the process the applicant has agreed to do an act (tolerating the dishonor of the mode of payment of EMIs of their customers) in lieu of such bounce charges being made to them as per the agreements.

Thus, **the applicant has agreed to do an act** (the act of tolerating, of delayed payment of EMIs by their customers) which is very clear from the terms and conditions of Loan Agreements entered into by them with their clients which very clearly provide that in case of any such breach as notified in Agreement, the applicant would tolerate the same subject to receipt of consideration in the form of Bounce Charges in return and such act, by the applicant, squarely falls under clause 5(e) of the Schedule II mentioned above and therefore the amounts received by the applicant for having agreed to do such an act, would attract tax liability under GST laws.

However the applicant has argued that the bounce charges shall not be covered by clause (e) of Entry 5 of Schedule II to the CGST Act, because according to the applicant, "agreeing to the obligation to

refrain *from an act, or to tolerate an act or a situation, or to do an act. It is submitted that the* expression "agreeing to the obligation" implies that there must be an agreement to the obligation in respect of any of the three entries. In absence of any such agreement, there cannot be a service.

We observe herein that the receipt of above mentioned bounce charges would be receipt of amounts for tolerating the act of their customers for having bounced the cheque or any other mode of payment. In view thereof, the same would definitely be a 'supply' under the GST Act and therefore, there arises an occasion to levy tax under the GST Act on the impugned transactions.

In their copy of agreement at page 19 of their submissions, with Punya Nath Mishra, in respect of an auto loan at point no.r of the said agreement it is mentioned that "*Bounce Charges" shall mean, dishonor of post-dated cheque/ECS ADM/entrusted by the borrower/co applicant/co borrower for clearance of EMI (monthly installments) or non-payment of installment on or before respective due date for other modes.*

We observe herein that the receipt of bounce charges on dishonor of cheques, etc, would be receipt of amounts for tolerating the act of their customers for having dishonored or where the client could not honour the said cheques and the same, would definitely be a 'supply' under the GST Act and therefore, there clearly arises an occasion to levy tax under the GST Act on the impugned transactions.

Thus we find clearly from the above discussions and as per the terms and conditions of the agreement submitted by them, there is clearly an agreement that the applicant, in the case of bouncing of cheques, etc by their customer, the applicant would tolerate such act of default or a situation and the defaulting party i.e their customer was required to compensate the applicant by way of payment of extra amounts in addition to principal and interest as per the terms and conditions of the Agreement. It is also very clear as to the amount or quantum which is consideration in the form of bounce charges to be received by the applicant if these, are suitable compensation only for tolerating the act of default or situation of default by their customers and they have clearly foreseen that such situation can be there and have, in their agreement, clearly devised a suitable mechanism for receipt of charges for the same and it is not additional interest as claimed by the applicant.

Thus we find that the consideration if any as received by the applicant would clearly qualify as 'supply' as per Sr. No. 5(e) of Schedule II of the CGST Act which reads as under:-

(5) Supply of Services : The following shall be treated as supply of services:-

"(e) Agreeing to the obligation to refrain from an act or to tolerate an act or a situation or to do an act.

In the present case, as per details presented before us, we clearly find that there is a clear understanding or agreement between the parties in the present case to foresee and tolerate an act or a situation of default on the part of the client for a monetary consideration which is actually a consideration received by the applicant, though in the agreement they may be giving this consideration, other names such as 'penal charges', penalty, Bounce Charges, etc, as thought proper by them, but these different nomenclatures in their Agreement would in no way change the actual nature of monetary "consideration" which would clearly be taxable for the supply of services as per Sr.No. 5(e) of Sch. II of the CGST Act, 2018.

To summarise, the exemption for financial transactions under GST laws is only in respect of the interest/discount earned or paid for loans, deposits or advances. If the transaction, as in the subject case deviates from the above, i.e. the consideration not being an interest or discount, the exemption is not

available. In the subject case the amount of bounce charges cannot be said to be penalty imposed on by the applicant. It is recovered/imposed only because the client has dishonoured the cheques issued by them towards payment of EMI. Dishonour of cheques i.e. a mode of repayment to the applicant by their customers, is an act which results in delay of receipt of repayments to the applicant. This delay is an act done by their customers which is tolerated by the applicant because inspite of such dishonour the applicant proposes to continue the agreement with the defaulting party. Thus we find that the recovery of bounce charges is made in view of toleration of the act of the client by the applicant and therefore construes as 'supply' as per as per Sr. No. 5(e) of Sch. II of the CGST Act and is therefore taxable under the GST Act.

06. In view of the deliberations as held hereinabove, we pass an order as follows:

ORDER

(under section 98 of the Central Goods and Services Tax Act, 2017 and the Maharashtra Goods and Services Tax Act, 2017)

NO.GST-ARA- 21/2018-19/B- 84 **Mumbai, dt.** 06.08.2019

For reasons as discussed in the body of the order, the questions are answered thus –

Question 1.:- Whether the Bounce Charges collected by the Applicant should be treated as a supply under the GST regime?

Answered in the affirmative.

PLACE: Mumbai

DATE: 06.08.19

—sd—
B. V. BORHADE
(MEMBER)

—sd—
PANKAJ KUMAR
(MEMBER)

CERTIFIED TRUE COPY

MEMBER
ADVANCE RULING AUTHORITY
MAHARASHTRA STATE, MUMBAI

Copy to:-
1. The applicant
2. The concerned Central / State officer
3. The Commissioner of State Tax, Maharashtra State, Mumbai
4. The Chief Commissioner of Central Tax, Churchgate, Mumbai.
5. Jt. Commissioner of S.T., Mahavikas, Mumbai for website.

Note :- An Appeal against this advance ruling order shall be made before The Maharashtra Appellate Authority for Advance Ruling for Goods and Services Tax, 15th floor, Air India building, Nariman Point, Mumbai - 400021