THE MAHARASHTRA APPELLATE AUTHORITY FOR ADVANCE RULING FOR GOODS AND SERVICES TAX

(constituted under Section 99 of the Maharashtra Goods and Services Tax Act, 2017)

ORDER NO. MAH/AAAR/SS-RJ/09/2018-19 Date- 11.09.2018

BEFORE THE BENCH OF

(1) Smt. Sungita Sharma, MEMBER

(2) Shri Rajiv Jalota, MEMBER

GSTIN Number	27AAECM2935R1ZV
Legal Name of Appellant	Maharashtra State Power Generation Company Limited
Registered Address/Address provided while obtaining user id	2ND Floor, Prakashgad, A K Marg, Bandra (East), Mumbai -400 051
Details of appeal	Appeal No. MAH/GST-AAAR-09/2018-19 dated 13.06.2018 against Advance Ruling No. GST-ARA-15/2017-18/B-30 dtd. 08.05.2018
Concerned officer/Jurisdictional Officer	Dy. Commissioner of State Tax, MUM-VAT-E-630

PROCEEDINGS

(under Section 101 of the Central Goods and Services Tax Act, 2017 and the Maharashtra Goods and Services Tax Act, 2017)

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 provisions under the MGST Act.

The present appeal has been filed under Section 100 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 Maharashtra State Power Generation Company Limited (herein after referred to as the "Appellant") against the Advance Ruling No. GST-ARA-15/2017-18/B-30 dated 08.05.2018

BRIEF FACTS OF THE CASE

A. The appellant is engaged in generation of power with object of making power available on affordable rates.

B. The appellant enters into contract with various contractors for the purpose of construction of new power plants or renovation of old plants or for operation of maintenance activities, etc. For example, the Appellant has awarded the contract to

M/s. BHARAT HEAVY ELECTRICALS LIMITED for the purpose of erection, testing & commissioning of main plant package.

C. As per the contract, the contractor is required to commence the trial operation of unit-1 and unit-2 by 41 and 44 months respectively from zero date i.e. the date of letter of award, in normal cases. Otherwise the contract provides for payment of Liquidated Damages. The relevant clause requiring the payment of Liquidated Damages in case of delay is reproduced below:

7.0 LIQUIDATED DAMAGES FOR DELAY IN ERECTION, TESTING AND COMMISSIONING

7.1 The Contractor shall strictly adhere to the Project completion schedule to achieve the trial operations of the units 1 & 2 by 41 and 44 months respectively. In case the Contractor fails to achieve successful completion of Trial Operation within specified time period as per the project completion schedule due to delay on his part, then the owner shall levy liquidated damages.

7.2 Time Schedules indicated for various activities are for the purpose of monitoring to ensure work completion as per Project Completion Schedule. Only the successful completion of Trial Operation of the unit shall be considered for the purpose of levy of Liquidated Damages.

7.3 The payment by Contractor or deduction by Owner of any sums under the provision of this clause shall not relieve the Contractor from his obligations to complete the works or from his other obligations under the contract.

7.4 The liability of payment of these liquidated damages by the Contractor will be established once the delay in successful completion of trial operation is established on the part of the Contractor and the Owner shall not be required to take any further action like arbitration or approaching the Court of Law for levying the Liquidated damages.

7.5 Since the Liquidated damages are limited and the same cannot compensate the consequential loss of the Owner due to delay on the part of the Contractor, the Owner reserves the right to get the work done at the risk and cost of the Contractor, in case delay on the part of the Contractor has been established after giving notice to the Contractor, as may be deemed fit in the interest of completing the balance works.

7.6 If the contractor fails to achieve the Trial Operation of the unit within the time period specified in the Project Completion Schedule due to reasons attributable to him then the owner shall levy Liquidated damages on the Contractor @ 1/2% of the contract price for erection, testing and commissioning (excluding insurance charges, taxes and duties) along with applicable price variation per week of delay or part thereof subject to the maximum 10% of the contract price for erection,

testing and commissioning (excluding insurance charges, taxes and duties) along with applicable price variation."

7.7 For the purpose of deciding the amount of Liquidated Damages on the erection price, contract price along with the applicable price variation (excluding taxes, duties and insurances charges.) as per contact price adjustment shall be considered.

7.8 Further Liquidated Damages for each unit shall be levied separately and for this purpose, price of one unit shall be half of the price of both the units.

Similar clauses are there in supply of balance of plant package, erection testing and commissioning of balance of plant package, supply of main plant package, civil and structural works of balance of plant package and various other contracts entered into with various parties. The Appellant enters into contract with various suppliers which inter-alia includes:

- BHARAT HEAVY ELECTRICALS LIMITED.
- BGR ENERGY SYSTEMS LIMITED.
- TATA PROJECT LIMITED.
- LANCO INFRATECH LIMITED

The contract is more or less similarly worded. Each such contract has time line for completion of the project and levy of Liquidated Damages, if not completed within time. The specimen clause reproduced above represents the manner and purpose of levying the Liquidated Damages for all the contracts.

D. The appellant filed the Advance ruling application dated 30.12.2017 under section 97 of the CGST Act, 2017 before the advance ruling authority.

E. The appellant also submitted the additional submission subsequent to the final hearing vide letter dated 07.03.2018. In the same submission the manner of recovery of the liquidated damages was explained, which is reproduced as follows:

As directed, a specimen running bill raised by M/s Bharat Heavy Electricals Limited, bearing no. MS/PW/9515/13/1027(89) is attached in the submission. In this case, 15% of the invoice amounting to Rs.56,29,471/- has been deducted as retention. This amount is deducted on invoice value of Rs.3,75,29,810/-.

For the sake of clarification as to retention @ 15% towards LD, when the maximum limit of LD is prescribed at 10%, it is to submit that in case of bills which were received and passed for payment before the scheduled completion date, no deduction is made on account of retention towards LD. After the expiry of scheduled work completion period, if the work is still not completed, the Appellant starts making deduction towards LD as retention amount. Since, the probable LD @ 10% will be imposed upon the entire contract value, the retention from each bill received after scheduled completion period is

to be made at accelerated rate so as to reach the intended amount based upon the entire contract value.

The contractor submits Running Account Bills during construction period and the same are passed in the manner specified above. After completion of the contract, the reasons for delay are assessed. If it is assessed that the delay in completion of contract was on the part of the contractor, then the amount of LD is finalised. The amount of LD so determined and kept as retention is transferred to LD Account and LD amount is then transferred to project cost and as such project cost is reduced to that extent.

This explains the manner in which the recovery of liquidated damages is made by the Appellant.

F. The advance ruling authority, vide order No. GST-ARA-15/2017/B-30 dated 08.05.2018, held that the GST will be levied on the liquidated damages, treating it as independent supply and rejected the contentions of the appellant.

G. Being aggrieved by the said order, the appellant is filing the present appeal.

GROUNDS OF THE APPEAL

1. Damages are paid for compensating the loss and not for any supply:

The Hon. Tribunal in the case of United Telecom Ltd. reported in 2006(204)-ELT-626 (Tri. - Bangalore) has referred to the extract from the book *"McGregor's Damages"*. The relevant extract is reproduced below:

*"**442.**Where the parties to a contract, as part of the agreement between them, fix the amount which is to be paid by way of damages in the event of breach, a sum stipulated in this way is classed as liquidated damages where it is in the nature of a genuine pre-estimate of the damage which would probably arise from breach of the contract. This is the modern phrase used to define liquidated damages, first appearing in Lord Robertson's speech in Clydebank Engineering Co. v. Don Jose Ramos Yzquierdo Y Castaneda and later incorporated by Lord Dunedine in his list of "rules" in Dunlop Pneumatic Tyre Co. v. New Garage and Motor Co. since when, as part of these "rules", it has often been resorted to. The intention behind such a provision is generally to avoid, wherever the amount of the damage which would probably result from breach is likely to be uncertain, the difficulty of proving the extent of the actual damage at the trial of the action for breach.*

***443.**A stipulated sum will, however, be classed as a penalty where it is in the nature of a threat fixed in terrorem of the other party. This is again the modern phrase, also to be*

found in Clydebank Engineering Co. v. Don Jose Ramos Yzquierdo Y Castaneda, this time in Lord Halsbury's speech, and also incorporated by Lord Dunedin in his list of "rules" in Dunlop Pneumatic Tyre Co. v. New Garage and Motor Co. The intention behind such a provision is generally to prevent a breach of the contract by establishing a greater incentive for its performance. The onus, however, of proving that a stipulated sum is a penalty rather than liquidated damages is upon the party against whom the stipulated sum if claimed.

***444.** The same sum cannot, in the same agreement, be treated as a penalty for some purposes and as liquidated damages for others. For if the same sum is extravagant and unconscionable in relation to one breach to which it applies it cannot be a genuine pre-estimate, and the sum becomes branded as having a penal nature which it cannot lose in relation to other more serious breaches to which it also applies. It adds nothing to say that it would not have been a penalty as to the other breach or breaches, or that it is the other breach or breaches that have in the event occurred. Nor will the court make any severance for the parties, once they have tampered with penal stipulations."*

It is evident from this that both the parties estimate the damages which will be caused for breach of contract and specify the same in the contract. Thus, this amount is not paid for any supply of service but paid for the compensation of the loss. This can be explained by an example. Say on a road a driver damages a car driven by Mr. X. The driver agrees to pay compensation for the damages to Mr. X. The amount is paid to compensate repair charges to the car of Mr. X. It therefore, cannot be said that Mr. X has supplied the services of toleration of an act to the driver. Rather, it is feared that the imposition of tax on such amount may not only be incorrect but also ultra vires.

2. Any supply is a voluntary act:

The GST is a contract base levy. The supplier agrees to supply the goods or services and the recipient agrees to pay the consideration. The supply made by the supplier is a voluntary act undertaken by him for making a supply.

It is submitted that in the case of damages specified in the contract, the recipient has no option but to accept the amount for the loss caused to him. He does not intend that the supplier should delay. Since in this case, the recipient has no option, but to accept the delay. It is submitted that it is a voluntary act by the recipient. Hence, the amount received is not for any services.

3. Entries in the clause (5) of Schedule-II shall be interpreted on the principle of ejusdem generis.

3.1 The Hon. Supreme Court in the case of Siddeshwari Cotton Mills (P) Ltd., Vs Union of India, 1989 (39) ELT 498 (SC) has observed in para 7 as follows:

7. The expression ejusdem-generis - 'of the same kind or nature' - signifies a principle of construction whereby words in a statute which are otherwise wide but are associated in the text with more limited words are, by implication, given a restricted operation and are limited to matters of the same class or genus as preceding them. If a list or string or family of genus-describing terms are followed by wider or residuary or sweeping-up words, then the verbal context and the linguistic implications of the preceding words limit the scope of such words.

In 'Statutory Interpretation' Rupert Cross says:

".....The draftsman must be taken to have inserted the general words in case something which ought to have been included among the specifically enumerated items had been omitted....." [page 116]

The principle underlying this approach to statutory construction is that the subsequent general words were only intended to guard against some accidental omission in the objects of the kind mentioned earlier and were not intended to extent to objects of a wholly different kind. This is a presumption and operates unless there is some contrary indication. But the preceding words or expressions of restricted meaning must be susceptible of the import that they represent a class. If no class can be found, ejusdem-generis rule is not attracted and such broad construction as the subsequent words may admit will be favoured. As a learned another puts it:

".....if a class can be found, but the specific words exhaust the class, then rejection of the rule may be favoured because its adoption would make the general words unnecessary; if, however, the specific words do not exhaust the class, then adoption of the rule may be favoured because its rejection would make the specific words unnecessary."

[See: Construction of Statutes by E.A. Driedger p. 95 quoted by Francis Bennion in his Statutory Construction page 829 and 830].

Francis Bennion in his Statutory Construction observed:

"For the ejus-dem-generis principle to apply there must be a sufficient indication of a category that can properly be described as a class or genus, even though not specified as such in the enactment. Furthermore, the genus must be narrower than the words it is said to regulate. The nature of the genus is gathered by implication from the express words which suggest it....." [p. 830]

"It is necessary to be able to formulate the genus; for if it cannot be formulated it does not exist. 'Unless you can find a category", said Farwell LJ, 'there is no room for the application of the ejus-dem-generis doctrine'." [p. 831]

In S.S. Magnild (Owners) v. Macintyre Bros. & Co. [1920 (3) KB 321] Me Cardie J. said:

"So far as I can see the only test seems to be whether the specified things which precede the general words can be placed under some common category. By this I understand that the specified things must possess some common and dominant feature."

In Tribhuban Parkash Nayyar v. Union of India [(1970) 2 SCR 732] the Court said:

".....This rule reflects an attempt to reconcile incompatibility between the specific and general words, in view of the other rules of interpretation, that all words in a statute are given effect if possible, that a statute is to be construed as a whole and that no words in a statute are presumed to be superfluous...." [p. 740]

In U.P.S. C. Board v. Hari Shanker [A.I.R. 1979 SC 65] it was observed:

".....The true scope of the rule of "ejusdem generis" is that words of a general nature following specific and particular words should be construed as limited to things which are of the same nature as those specified. But the rule is one which has to be "applied with caution and not pushed too far" ....." [p. 73]

The Supreme Court in case of M/s Rohit Pulp and Papers Ltd. 1990 (47) ELT 491 (SC) in para 10 observed as follows: -

10. "The principle of statutory interpretation by which a generic word receives a limited interpretation by reason of its context is well established. In the context with which we are concerned, we can legitimately draw upon the "noscitur a sociis" principle. This expression simply means that "the meaning of a word is to be judged by the company it keeps." Gajendragadkar, J. explained the scope of the rule in State v. Hospital Mazdoor Sabha (1960-2 S.C.R. 866) in the following words:

> *"This rule, according to Maxwell, means that, when two or more words which are susceptible of analogous meaning are coupled together they are understood to be used in their cognate sense. They take as it were their colour from each other, that is, the more general is restricted to a sense analogous to a less general. The same rule is thus interpreted in" Words and Phrases" (Vol. XIV, p. 207) : "Associated words take their meaning from one another under the doctrine of noscitur a sociis, the philosophy of which is that the meaning of a doubtful word may be ascertained by reference to the meaning of words associated with it; such doctrine is broader than the maxim Ejusdem generis." In fact, the latter maxim "is only an illustration or specific application of the broader maxim noscitur a sociis". The argument is that certain essential features or attributes are invariably associated with the words "business and trade" as understood in the popular and conventional sense, and it is the colour of these attributes which is taken by the other words used in the definition though their normal import may be much wider. We are not impressed by this argument. It must be borne in mind that noscitur a sociis is merely a rule of construction and it cannot prevail in cases where it is clear that the wider words have been deliberately used in order to make the scope of the defined words*

correspondingly wider. It is only where the intention of the Legislature in associating wider words with words of narrower significance is doubtful, or otherwise not clear that the present rule of construction can be usefully applied. It can also be applied where the meaning of the words of wider import is doubtful; but, where the object of the Legislature in using wider words is clear and free of ambiguity, the rule of construction in question cannot be pressed into service."

This principle has been applied in a number of contexts in judicial decisions where the Court is clear in its mind that the larger meaning of the word in question could not have been intended in the context in which it has been used. The cases are too numerous to need discussion here. It should be sufficient to refer to one of them by way of illustration. In Rainbow Steels Ltd. v. C.S.T. (981-2 S.C.C. 141) this Court had to understand the meaning of the word `old' in the context of an entry in a taxing tariff which read thus:

> *"Old, discarded, unserviceable or obsolete machinery, stores or vehicles including waste products"*

Though the tariff item started with the use of the wide word `old', the Court came to the conclusion that "in order to fall within the expression `old machinery' occurring in the entry, the machinery must be old machinery in the sense that it has become non-functional or non-usable". In other words, not the mere age of the machinery, which would be relevant in the wider sense, but the condition of the machinery analogous to that indicated by the words following it, was considered relevant for the purposes of the statute".

4. <u>The clause (5) of Schedule-II needs to be interpreted on the basis that GST is destination-based consumption tax</u>

4.1 The Goods and service Tax is contract-based levy and the nature of services rendered shall be determined on the basis of contract entered into between the provider of service and recipient of service. This principle shall be applied in interpreting the entry (e) of clause (5) of Schedule-II which reads as follows:

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

This clause can be divided into following 3 sub clauses:

(a) Agreeing to the obligation to refrain from an act,
(b) Agreeing to the obligation to tolerate an act or a situation,

(c) Agreeing to the obligation to do an act.

4.2 It is submitted that the words 'agreeing to the obligation' appearing in clause (e) applies to all the 3 activities. As per the contract, the provider of service here agrees to refrain or tolerate or to do an act. This act of provider benefits recipient. Therefore, recipient consumes the service and pays for the same. All the 3 situations can be explained by an example.

(a) Refrain from Act – Very often, the parties enter into agreement for non-compete with each other. For example, in case of sale of brand name or on-going concern or dissolution of partnership etc. Say X person sell brand name B to Y. X may agree that he will not sell similar product under any other brand in the market for a specified number of years. X may be paid for refraining from selling similar products for specified number of years. In this case, as per the contract, X specifically refrain himself from acting (selling) the product B. Since agreement to refrain forms the contract between X and Y, refrainment of X will be taxable under this category. The refrainment of X for not selling the similar products benefits Y.

(b) Tolerate the Act or Situation - Similarly, the person or institution may agree to tolerate an act of others. It is common knowledge that whenever repairs or major interior work is undertaken in the society, the society frames certain regulations to avoid inconvenience to the members of the society. Example, work is permitted between the given hours or material like cement, steel etc. are allowed to be carried in the lift during a particular time etc. The society also charges the person carrying out the repair for the inconvenience caused to other members. This, in commercial term, is known as "hardship amount". In such situation, the members agree to tolerate the act carried out by other person. This benefit the society in the form of certain consideration. Such situation can be taxed under this category.

(c) To do an Act - Provider of service may sometimes agree for doing a particular act for which he receives payment. In the commercial world, very often, suppliers enter into agreement with purchaser for selling his product only. Very often, we see in theatre cold drink with brand name of particular company is only sold. The retailers enter into agreement with the company like Pepsi, Coca Cola, Parle, etc. that they will sell the cold drink of particular brand of the company and he will not sell the cold drink of other company. In such case, retailers agree to act in a particular manner for which he is paid the amount.

4.3 In all the above situation, there is specific agreement by the provider to carry out obligation specified in the contract. Therefore, this event is taxable. In the case of liquidated damages, there is no agreement to tolerate any situation or act.

5. Taxable supply arises on performance of activity

5.1 The section 7 defines 'supply' 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 such as sale, transfer, barter, exchange, license, 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.

(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, a State Government or any local authority in which they are engaged as public authorities, as may be notified by the Government on the recommendations of the Council, 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.

The performance of any action by the person is important to consider as supply. Further it provides that activities to be treated as supply of goods or supply of services as referred in schedule II. It is submitted that in respect of services specified in clause 5 of schedule II, the service provider must carry out the activity. The taxability arises when the provider of service carries out certain activity. The clause 5 of schedule II specifies services in 6 different entries. It is submitted that in all the 6 entries pre-supposes performance of activity either active or passive. The taxable event occurs when provider performs the services. This will be evident from the following table that different activities must be carried out by the provider.

Sr. No.	Entry No. of Clause 5 of Schedule-II	Description	Nature of activity
1	(a)	Renting	Permitting use of immovable property
2	(b)	Construction of complex	Builder/developer carries out construction
3	(c)	Temporary transfer or permitting use	Provider permit the recipient enjoyment of property
4	(d)	Development, design etc of information technology software	Provider carries out any of the activity like development, design etc. for rendering taxable service
5	(e)	Agreeing to the obligation	Provider shall specifically agree to obligation to carry out acts mentioned therein.
6	(f)	Transfer of goods by different means	Provider transfer right to use any goods for any purpose (whether or not specified for a specified period) for cash, deferred payment or other valuable consideration.

5.2 It is evident from the above submission that applicability of various services mentioned in the clause (5) of Schedule-II pre-supposes performance of certain activity by the provider of service. The nature of activities to be performed by the provider is also specified in the above table. It is therefore submitted that based on the principle of interpretation of ejusdem generis, the activity specified in clause 5 of schedule II will become taxable only when the provider of service has performed certain activity. It is submitted that all these clauses shall be interpreted based on the principle of interpretation known as ejusdem generis. The meaning takes colour from the preceding or succeeding clauses. The word tolerating an act is preceded by the word "Refrain from an Act" and succeeded by "To do an Act". Both these pre-supposes the voluntary act from the supplier to perform in a particular manner. Therefore, acceptance of damage amounts for compensating the loss and it cannot be considered as a 'Tolerating of an Act'

6. <u>The Liquidated damages cannot be treated as independent supply. Therefore, the impugned advance ruling passed by the authority needs to be set aside.</u>

6.1 <u>The liquidated damage is not an independent supply or divisible contract: -</u>

The authority has held that the liquidated damage (LD) is an independent levy from the performance of contract. It has been further alleged that the supply of service occurs

first and then delayed performance of contract is ascertained. This has been alleged on the ground that no clause in the contract relating to contract price or deduction mentions the deduction regarding of liquidated damages.

The liquidated damage is part of the contract for supply of equipment and service. It is not a separate contract of toleration of an act for which payment is made. The Appellant had attached one of the contracts with M/s BHEL as specimen. It is submitted that it is one single contract for supply of goods and services and not two contracts for supply of goods, services and toleration of an act.

The Divisible contract has been defined in Black's Law Dictionary, Sixth Edition, Page no. 479, as follows:

6.2 **Divisible contract**

"One which is in its nature and purposes susceptible of division and apportionment, having two or more parts in respect to matters and things contemplated and embraced by it, not necessarily dependent on each other nor intended by the parties so to be."

The term "divisible contract" whose synonym is "severable contract" is also defined in the same dictionary on page no. 1373 as under: -

6.3 **Severable contract: -**

A contract which includes two or more promises which can be acted separately such that the failure to perform one promise does not necessarily put the promisor in breach of the entire contract. A contract, the nature and purpose of which is susceptible of division and apportionment, having two or more parts, in respect to matters and things contemplated and embraced by it, not necessarily dependent upon each other, or intended by parties as being dependent. Gross v. Maytex Knitting Mills of Cal., 116 C.A.2d 705, 254 P.2d 163, 167. See separability clause.

When a contract is severable, a breach may be found to constitute a default as to only the specific part breached, thus relieving the defaulting party from liability for damages for breach of the entire contract.

6.4 Hence, the execution of the contract and deduction cannot be enforced separately. The delay in supply will always precede deduction of liquidated damages. Thus, deduction of liquidated damages cannot be independently enforced. Hence it is submitted that the contract is for single supply and not for the two supplies. In any contract if the activities are depended on each other and it cannot be performed individually, then there will not to be two separate supplies. In a contract two supplies can be

considered only when two supplies are independent and not depending on each other. In this case, the deduction of the amount is determined on delay in making supply of goods or services by the contractor. Unless, there is delay the clause of liquidated damage will not apply. Therefore, it is submitted that contract is single supply and not for two separate supply.

6.5 It is submitted that there are no two separate promises in the contract. The appellant has entered into a contract as per which the contractor is required to perform the erection and commissioning of the plant within a given stipulated time period. This cannot be taken as two separate promises by the contract. The price of the contract is also dependant on the fact of performance of the activity by the contract within a given period of time. Thus, if the activity is not performed within the stipulated time, the contract price will definitely be varied.

6.6 Further, the basis on which the authority has contended that the claiming of LD is an independent activity is that the LD is not mentioned as an allowable deduction under the clauses of contract price and deduction. It is submitted that the agreement in clause 7.3 of the special conditions to the contract, reproduced in para 3 of the facts of the case above, clearly mentions that the liquidated damages can be in the form of deduction. Therefore, the contention of the authority that the contract clause relating to contract price and deduction do not make a mention to LD and thus LD cannot be considered as varying the contract price is incorrect. Further, the authority have themselves mentioned in para 6 of the order that if there was specific clause under the relevant clauses for deduction of LD, the same would not affect the levy of GST on the same. It is evident that there is a serious contradiction in the views of the authority.

6.7 It is submitted that the important point to be considered in the present case is that whether the claiming of LD is a supply of service or re-determination of the value of original supply. It does not matter under which clause of the agreement the provision of LD is mentioned. Further, the LD is not a separate supply will be evident from the submissions below. Therefore, the contention of the authority is not sustainable.

7. This fact is also evident from the provision of Section 15(2) of the GST Act,2017.

7.1 The Section 15 provides for determination of value of any supply. The section 15(2)(d) reads as follows: -

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

It is evident from the same that the interest, late fees or penalty will be added to the consideration of the original supply. They will not be considered as a separate supply of toleration of an act. If the intention of the legislature was to tax such penalties under the clause 'toleration of an act', then there was no need for adding this clause in section 15. They would have automatically got covered under the entry 5(e) of schedule II. The penalty will be leviable for breach of any condition of contract. The penalty as per statutory provision, therefore has been considered as a part of value of supply and not as amount received for toleration of an act. Similarly, interest will be charged for delay in making payment by the recipient. The interest therefore cannot be considered as part of amount received for toleration of an act or delay in making payment.

In view of the above, it is submitted that the liquidated damages cannot be considered as separate supply, or the amount received for tolerating an act.

8. Liquidated Damages reduces the value of main supply and the payment of liquidation damages as part of the same supply is mere re-determination of the consideration of the same supply if the has been specified in the original contract.

9. The relevant provision for determination of Transaction value under the GST law is similar to that in the Excise regime. It has been consistently held under the excise regime that liquidated damages has the effect of re-determining the transaction value. Clause (d) of Section 4(3) Central Excise Act, 1944 defines the expression "transaction value" as *follows;*

"means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods."

10. The appellant relies on the following judgments wherein it has been held that the Transaction value should not include the amount of Liquidated Damages and hence the duty was payable on the transaction value after considering the amount of Liquidated Damages:

a) COMMR. OF C. EX., CHANDIGARH-I Versus H.F.C.L. (WIRELESS DIVISION) 2015 (11) TMI 893 - CESTAT NEW DELHI

b) VICTORY ELECTRICALS LTD 2013 (298) E.L.T. 534 (Tri. - LB)

c) M/s. Priyaraj Electronics Ltd. Versus Commissioner of Central Excise Bangalore 2016 (6) TMI 873 - CESTAT BANGALORE.

d) UNITED TELECOM LTD 2006 (204) E.L.T. 626 (Tri. - Bang.)

Under GST law, section 15(1) of the GST Act reads as follows:

15. (1) 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.

Section 15 of the CGST, Act 2017, which is similarly worded i.e. under both the Acts, tax is levied on the transaction value which is the price actually paid or payable. Therefore, the ratio of the above cited judgements can also be applied to the section 15(1) of the GST Act, 2017 and it can be concluded that resultant price after Liquidated Damages would be the transaction value under section 15(1) of the GST Act,2017.

11. In the present case, the contract entered into with the contractor gives the nature of services, the value of services and the time frame within which the services are required to be completed. The contractor undertaking the supply of service is aware of the fact that in case the services are not completed within the stipulated period, the value of contract will reduce. Since the recovery of Liquidated Damages is a part of the contract, it is submitted that the value of the main supply reduces to the extent of Liquidated Damages deducted by the Appellant.

12. The authority has distinguished the judgment relied upon by the appellant on the ground that in those judgments, the contract clearly specified reduction of transaction value in the case of delayed delivery which is not there in the present case.

13. It is submitted that the contention of the authority is not correct. The relevant extract of the facts in the case of Victory Electricals Ltd (supra) is reproduced below:

7. The assessee was engaged in manufacture of electrical transformers. During the relevant period, respondent supplied transformers to various Distribution Companies (discoms) of the Andhra Pradesh State Electricity Board (APSEB). Clause (2) of the purchase order provides for variation in the price, by way of revision (upward or downward) ab initio, to accommodate variations in prices of raw materials in terms delineated in the said clause. ***Clause (12) of the purchase order stipulates that for supplies made beyond the agreed delivery schedule, penalty shall be levied for an amount equivalent to ½% of the value of the material not delivered within the prescribed time limit for every week of delay or part thereof, subject to a maximum of 5% of the total contract value.*** *This clause also contains a provision which enables*

the purchaser (APSEB) to purchase the balance quantity (undelivered within the delivery schedule) from the open market and recover the expenditure incurred thereof from the assessee.

14. It can be seen from the above that the contract between the parties does not specify that the amount of liquidated damages will be reduced from the contract price. Further, the contract mentions the liquidated damages to be in the nature of penalty. Also, the term used for recovery of LD is 'levy'. The facts in the above case are similar to the present case. Therefore, the judgment can be applied to the present case.

15. Further, once it is established that the amounts are in the nature of liquidated damages, it is not of much importance under which clause the same is mentioned. **This is because, once it is liquidated damages, it will have to be reduced from the price payable and therefore tax will be levied on the net amount.** Therefore, the contention of the authority is not sustainable.

16. Under the service tax law also, in case of re-negotiation on account of deficient provision of service, revised amount will be the amount of consideration liable to tax.

17. Further, the CBEC, vide their circular dated 31.03.2011, clarified the service tax rule,1994, explaining that in case of renegotiation of the amount of consideration in terms of the contract, then the service tax will be payable on such revised amount, subject to the fact that the excess amount is either refunded or a suitable credit note is issued to the service receiver. The relevant extract reads as follows:

11. Changes have also been made in the Service Tax Rules, 1994 vide Notification No. 26/2011-S.T., dated 31-3-2011 and have a close relationship with the Point of Taxation Rules as follows:

(i) The obligation to issue invoice shall be within 14 days of completion of service and not provision of service.

(ii) *If the amount of invoice is renegotiated due to deficient provision or in any other way changed in terms of conditions of the contract (e.g. contingent on the happening or non-happening of a future event), the tax will be payable on the revised amount provided the excess amount is either refunded or a suitable credit note is issued to the service receiver. However, concession is not available for bad debts.*

18. It is evident from the above circular, that in case the consideration for any other service is changed as per the term and conditions laid down in the contract, then service tax will be payable on the renegotiated amount. These provisions in rule 6(3) were continued even after July 2012. The section 66E declared "agreeing to obligation to tolerate an act" as taxable supply even then the above clarification continued.

19. In the present case, there is deficient provision of service in as much as the contractor could not complete the service within the stipulated time period. Therefore, applying

the ratio of the above circular, it can be said that tax will also be levied on the revised amount of consideration only.

20. Reliance is also placed on Australian Ruling issued under the Australian Goods & Service Tax Act, 1999:

The appellant had submitted the below arguments before the authority also. However, the authority has not discussed the said submission of the appellant in the order. Therefore, the same is being reproduced.

The Australian Goods & Service Tax Act, 1999 defines 'supply' u/s. 9-10(1) as follows:

A *supply* is any form of supply whatsoever.

The Sub-Section 9-10(2) further provides as follows:

Without limiting sub-section (1), supply includes any of these:

(a) a supply of goods;
(b) a supply of services;
(c) a provision of advice or information;
(d) a grant, assignment or surrender of real property;
(e) a creation, grant, transfer, assignment or surrender of any right;
(f) a financial supply;
(g) an entry into, or release from, an obligation:
(i) to do anything;
(ii) to refrain from an act;
(iii) to tolerate an act or situation;

(h) any combination of any 2 or more of the matters referred to in paragraphs (a) to (g).

21. Rulings are issued by Australian Tax Authority to interpret and clarify the provisions of GST law prevailing in that country. The ruling is an expression of the Commissioners opinion about the way in which the relevant provision applies or would apply to the entities, generally to a class of entities in relevant to a particular scheme. The Commissioner issued the public ruling on the payment of damages on early termination of lease of goods, cancellation of contracts and out of court settlements wherein they had discussed the taxability of the liquidated damages. The same along with cases and books has been discussed as follows:

- In GSTR 2003/11 of Goods and service tax ruling relating to payment on early termination of lease of goods, it was clarified that if clause relating to early termination has been specified in the original contract of lease and early termination has been in accordance with the said contract than termination payment will be considered as

change of consideration of earlier supply (i.e. re-determination of consideration). It will not be considered as separate supply, but will be considered as adjustment event in relation to that earlier supply.

- The book Australian Master GST Guide written by Philip McCouat (2014) 15th Edition contains Australian GST Act and application of the same. The paragraph 4-085 deals with damage awards and out of court settlements. The said paragraph clearly provides that there is no supply when any charge is collected for termination of breach of contract. The extract of book is reproduced below:

> *"However, the Tax Office accepts that there is no supply where the order or settlement is wholly concerned with finalizing a claim for damages or compensation for previous property damage, negligence causing loss of profits, breach of copyright, wrongful use of trade name, personal injury,* ***termination or breach of contract****.* ***In such cases, there is therefore no GST liability****.*

22. Thus, Australian GST has treated the payment of liquidation damages as part of the same supply and mere re-determination of the consideration of the same supply if the has been specified in the original contract i.e. if liquidation of damages are to be borne by the service provider then same will be considered as towards deficiency of services and thereby reduces the original consideration and it will not be considered as separate service and hence it is not covered by the term *'Obligation to tolerate an act or a situation'*.

23. The deficiency of service may arise on account of poor quality of service or delay in rendering the service and therefore it is our interpretation that deduction of the contract price on account of delay in contract will be considered towards deficiency of service and therefore will not liable to GST in the hands of the Appellant.

24. It is to be noted that 'an obligation to tolerate an act' is also a supply which is similar to the provisions in India. The tax officers in Australia have decided the taxability of LD in the background of this provision also.

25. Liquidated damages cannot be said to be the payment for tolerating an act or a situation.

26. The entry in 5(e) of schedule II of GST Act under which the authority has classified the service reads as follows:

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

27. It is submitted that there should be a separate contract to tolerate an act and receive payment for the same. The word "obligation" used in clause clearly means that the person should undertake to tolerate an act. There should be a contract for the said purpose and the consideration should be received for such an act of toleration. For e.g. an event management company pays certain amount to the residents of a locality to tolerate the loud music for the full night for an event. In this case, the residents tolerate the act of the event management company.

28. In the present case, the amount deducted is only for compensate for loss and not for toleration of an act. Therefore, not a separate supply liable for tax. Hence, no GST is payable.

29. It is submitted that primary intention of the parties in agreement is not to 'tolerate' an act or a 'situation'.

30. Performance is the essence of a contract and hence parties to contract generally incorporate their expectation in terms of damage caused by failure of either party to perform its obligations completely or as per the agreed terms.

31. The contract may prescribe damages for deficiency in the performance of contract known as 'liquidated damages'. It is to dissuade unsatisfactory performance or non-performance. For instance, contracts state that time is the essence of contract, and any delay invites say, 1/2% or 1% of the value of the contract for every week of delay and the like. Similarly, it is common to forfeit earnest money deposit (EMD) from a bidder in case he wins the bid but fails to act thereafter. This forfeiture clause is a deterrent for non-serious bidders entering the fray. Other examples may be rent for delay in lifting goods; agreeing to shoulder testing charges for samples to meet standards; cost of removing rejected goods, etc.

32. Payment of damages, deducting the liquidated damages or the forfeiture of deposit does not restitute the person to whom loss or damage is caused. Liquidated damages are in nature of a measure of damages to which parties agree, rather than a remedy. By charging damages or forfeiture, one party does not accept or permit the deviation of the other party. It is an expression of displeasure. **Liquidated damages cannot be said to be the desired income.** It is for compensation of loss suffered by recipient.

33. Intention of contracting parties are essential to determine nature of transaction. Further, Various courts in India have time and again held that for determining the Tax implications with regard to a transaction, reliance needs to be placed on the intention of the contracting parties as gathered from the contract or conduct of the parties.

34. In case of **Dr Golak Bihari Mohanty vs. State of Orissa, [1974] 33 STC 514 (Orissa),** the assessee was carrying on private practice as a radiologist and for that purpose had installed an X-ray plant. He used to purchase X-ray plates and other chemicals and

take X-ray photographs of patients according to requisitions from physicians as also of his own patients.

35. After taking the X-ray, he used to give technical advice to his patients and was charging a flat rate towards his remuneration and cost of materials. Sales Tax Officer was of the view that the turnover arising from such transactions was liable to tax under the Act. The hon'ble High Court of Orissa held that:

'Mere passing of property in an article or commodity during the course of the performance of the transaction in question does not render it a transaction of sale. For, even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of sale of those materials. In every case the court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it.'

36. Similarly, In case of Liquidated Damages settled in case of Lumpsum Turn-key ('LSTK') contracts, one really needs to appreciate whether settlement so made under LSTK contracts (say for constructing and delivering a Power plant) represents the primary intention of the contracting parties or such settlement though attributed to the execution of the contract is merely incidental and does not represent the primary intent and objective of the parties which obviously logically and legally continues to construct and deliver a power plant.

37. At best these settlements could be considered to be an adjustment or a reduction in the contractual consideration or compensation to be received by the contractor. However, considering these settlements as a separate and distinct 'supply' from that of the LSTK's scope and ambit seems to be a bit too far stretched.

38. If this argument is found to have some merit, then what could possibly attract levy of GST under the impugned clause could be an arrangement where primary intention is to tolerate an act or a situation.

39. Recovery of damages cannot be equated to supply of service:

39.1 Liquidated damages are recovered for compensating the loss/damage suffered by the recipient.

The section 73 and section 74 of the Indian Contract Act, 1872 provides for recovery of liquidated damages in case of breach of contract. The provision of the section 73 and section 74 of the Indian Contract Act, 1872 reads as follows: -

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.

  Exception —When any person enters into any bail-bond, recognizance or other instrument of the same nature, or, under the provisions of any law, or under the orders of the 2[Central Government] or of any [State Government], gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable, upon breach of the condition of any such instrument, to pay the whole sum mentioned therein.

  Explanation —A person who enters into a contract with Government does not necessarily thereby undertake any public duty or promise to do an act in which the public are interested.

40. It has been consistently held that liquidated damage is to compensate the person for loss suffered by him. In the present case, when the contractor does not complete the erection and commissioning of the plant on time, it leads to loss to the appellant in the form of opportunity to generate and supply electricity and the profits forgone on the same. Therefore, it is submitted that the damages are not received by the person for the toleration of an act, but it is made for compensate the loss suffered by the appellant. Therefore, it is submitted that recovery of liquidated damage is not for any supply of service for toleration of an act.

41. Reliance is placed on rulings in the Australian Law wherein it has been held that payments on account of damage do not constitute a supply.

a) The contract may prescribe damages for deficiency in the performance of contract known as 'liquidated damages'. It is to dissuade unsatisfactory performance or non-performance. Payment of damages is to compensate loss suffered by a person.

b) It is submitted that there was an issue under the Australian GST regarding payment of GST on damages awarded by a court order. It was held under that law that payment of damages alone does not constitute a supply and thus no GST shall be payable. It is submitted that the present issue also relates to taxability of damages payable by contractor to the appellant in terms of the contract. Thus, the ratio can apply to the present case. Therefore, the submissions are being made below.

c) Section 9-10 of Australian GST defines 'supply' as follows:

"(1) A supply is any form of supply whatsoever.
(2) Without limiting subsection (1), supply includes any of these:
(a) a supply of goods;
(b) a supply of services;
(c) a provision of advice or information;
(d) a grant, assignment or surrender of real property;
(e) a creation, grant, transfer, assignment or surrender of any right;
(f) a financial supply;
(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;
(h) any combination of any 2 or more of the matters referred to in paragraphs (a) to (g).

The definition of supply in section 7 of GST Act is same as given in section 9-10 of Australian GST Act. Both include all forms of supply. Further clause 5(e) of schedule II to GST Act declares 'agreeing to an obligation to refrain from an act, or to tolerate an act or a situation, or to do an act' as service. Similar provisions are made in clause (g) of Section 9-10 of The Australian GST Act. Therefore, ratio of cases laid down in Australia should apply to provisions of Indian GST Act.

d) In the case of Shaw v Director of Housing & Anor (No.2) 2001 ATC 4954, the party has reached settlement for payment of damages. However, the parties were unable to agree whether or not the plaintiff will incur liability to pay tax as a result of payment of judgment sum under the new Goods & Service Tax Act, 1999. Mr. McElwaine who appeared for plaintiff submitted that that when the Court finally assesses the damages and makes an order, that judgment be entered for the plaintiff against the defendants for a specified sum of money, the defendants will be under an obligation to pay the money. Mr McElwaine then submitted that it was arguable that upon payment of that sum the plaintiff will make a supply within the meaning of the Act, s 9-10(2)(g) in that he will thereupon release the defendant from an obligation to pay the money.

The Court in para 14 and para 18 observed as follows and held that no GST is payable when the plaintiff has made payment of the damages to respondent.

> *14. In both countries it has been held that ``supply'' is a word of very wide import. Customs & Excise Commissioners v Oliver [1980] 1 All ER 355. However, counsel did not refer me to any case in New Zealand or the United Kingdom in which the argument raised by Mr McElwaine has been considered and my own researches have revealed none. It seems that at least in New Zealand, absent a connection with a taxable supply, a release of an obligation for consideration within the meaning of the Act, s 9-10(2)(g) is not considered to be a supply. In Case 577 (1996) 17 N ZTC 7483 a compromise of a cause of action was held not to be a supply. In that case farmers were burning off scrub on their farm when the fire got out of control and damaged some machinery belonging to contractors. The contractors commenced proceedings for damages but the action was settled out of court by the payment of a sum of money and the striking out of the proceedings by consent. Barber DJ held that the abandonment of their claim in return for payment of money did not involve a supply. He said, at 7487:*
>
> > *"All that has passed between the [farmers] and [the contractors] physically is the payment or handing over of a cheque. In the abstract, all that has passed between them is the surrendering by the [contractors] of their right to proceed with their claim against the [farmers]. That surrender is not a supply."*
>
> *18. The obligation of the judgment debtor to pay the judgment sum is extinguished by the act of payment. The extinguishment or release does not depend upon any action on the part of the judgment creditor. As White J said in Inter chase at par 54 [at 4554]:*
>
> > *"A taxable supply is made if the supply is made for consideration (s 9-5(a)). Consideration includes matters done pursuant to orders of a court (s 9-15(2A)(a)) but that does not of itself constitute a supply. The receipt of payment by a judgment creditor does not obviously involve the creation, grant, transfer, assignment or surrender of any right or the entry or release from an obligation (s 9-10(2)(e)(f)). When the judgment is satisfied the debt created by the judgment is thereby extinguished and does not depend on the surrender of any rights or the release of the judgment debtor."*

e) Further, Australian Tax Office publishes Goods & Service Tax Rulings. They have published GST Ruling titled 'Goods & Service Tax on consequences of court orders and out-of-court settlements". The purpose of rulings has been explained in para 1 as follows:

> *1. This Ruling considers the goods and services tax (GST) consequences resulting from court orders and out-of-court settlements. It explains how a payment (or act or*

forbearance) that is made in compliance with a court order or out-of-court settlement should be treated for the purposes of A New Tax System (Goods and Services Tax) Act 1999 (the GST Act).

In para 71 to 73 it is observed as follows:

Where the subject of a claim is not a supply

71. Disputes often arise over incidents that do not relate to a supply. Examples of such cases are claims for damages arising out of property damage, negligence causing loss of profits, wrongful use of trade name, breach of copyright, termination or breach of contract or personal injury.

72. When such a dispute arises, the aggrieved party will often assert its right to an appropriate remedy. Depending on the facts of each dispute a number of remedies may be pursued by the aggrieved party in order to ensure adequate compensation. Some of these remedies may be mutually exclusive but it is still open to the aggrieved party to plead them as separate heads of claim until such time as the matter is resolved by a court or through negotiation.37

73. The most common form of remedy is a claim for damages arising out of the termination or breach of a contract or for some wrong or injury suffered. <u>This damage, loss or injury, being the substance of the dispute, cannot in itself be characterised as a supply made by the aggrieved party. This is because the damage, loss, or injury, in itself does not constitute a supply under section 9-10 of the GST Act</u>

On a combined reading of judgments and rulings, it is evident that award of damage by Court does not in itself constitute a supply by the person receiving such damage. Currently, there are no rulings from authority in India. However, very often, courts have followed rulings of other nation to decide similar issues. Therefore, in view of the above, no GST will be payable by the company on the amount payable to claimant by querist as per the award of Arbitrator Court.

42. The reply to question no.(e)of the appellant was based on incorrect fact: -

The question no. (e), reads as follows: -

(e) If some part of delay has occurred before GST roll-out and some part of delay has occurred after GST roll-out, whether GST will be applicable to the liquidated damages imposed for entire period of delay or to the period falling after GST roll-out? In case when GST is to be imposed for period after date of GST rollout but due to maximum capping of

liquidated damages, the amount of liquidated damages is calculated at given percentage instead of being period-based, then how GST needs to be levied.

It was mentioned in the order that no strategy of deducting or of capping can be inferred from the agreement clause.

In response to the same it is submitted that the strategy of deducting or the capping is given the clause 7.6 of the contract and the same was also mentioned in the statement of the fact of the application for advance ruling. The same is reproduced as follow: -

7.6 If the contractor fails to achieve the Trial Operation of the unit within the time period specified in the Project Completion Schedule due to reasons attributable to him then the owner shall levy Liquidated damages on the Contractor @ 1/2% of the contract price for erection, testing and commissioning (excluding insurance charges, taxes and duties) along with applicable price variation per week of delay or part thereof subject to the maximum 10% of the contract price for erection, testing and commissioning (excluding insurance charges, taxes and duties) along with applicable price variation."

43. It is submitted that the Honourable Advance Ruling Authority itself has reproduced the above in para 5 (page no. 9) of its order. Therefore, the findings of the authority are incorrect to this extent.

Hearing

44. Hearing in the matter was fixed on 14.08.2018 which was attended by Shri S.S. Gupta, C.A., the representative of the Appellant and Shri S.D. Page, Deputy Commissioner of State Tax, in the capacity of the Jurisdictional officer. The Appellant as well as respondents reiterated their written submissions during the said hearing.

DISCUSSION AND FINDINGS

45. We have gone through the facts of the case. The question put forth by the appellant is whether the levy of liquidated damages would be supply of services by the appellant u/s. 7(1)(d) of the CGST Act, 2017 as referred at Sr.No.5(e) in Schedule 2 to the CGST Act. The appellant has contended the following:-

1. There is no explicit agreement between the Company and the contractor wherein the appellant is intending to supply services in the form of tolerance of the delay.
2. The delay is neither desired by the Company nor by the Contractor but it is done to impress upon the contractor to adhere timelines.
3. Payment of damages does not restitute the person to whom the loss or damages is caused.

4. Liquidated damages are in the nature of measure of damages to which parties agree rather than the remedy.
5. Liquidated damages is not the income of the appellant but compensation for the loss suffered by the appellant. There is no contract between the parties and there is no supply of services for tolerance of an act.

46. The Authority for Advance Ruling has held that the payment of liquidated damages by the contractor to the appellant is covered by the term 'Obligation' to tolerate an 'act' or a 'situation' and is taxable under the provisions of the CGST Act. In order to understand the issue, let us refer to the relevant clauses of specimen contract:-

10.0 LIQUIDATED DAMAGES

10.1 If the Contractor fails to achieve the trial operation of the unit within the stipulated time period as indicated above from the zero date then the Owner shall levy Liquidated Damages on the contractor @1/2% of the contract price for Erection, Testing & Commissioning along with applicable price variation price per week of delay or part thereof subject to a maximum of 10% of the price for Erection, Testing & Commissioning along with applicable price variation. For the purpose of levy of liquidated damages, the contract price for Erection, Testing & Commissioning excluding Insurance charges and taxes & duties and the same for one unit shall be half of the total price.

Section 3 of the Contract which refers to the special conditions of the contract also lays down the provisions for payment of liquidated damages by the Contractor to the appellant.

- **Section 3 – Special Conditions of Contract**

7.0 LIQUIDATED DAMAGES FOR DELAY IN ERECTION, TESTING AND COMMISSIONING

7.1 The Contractor shall strictly adhere to the Project Completion Schedule to achieve the trial operations of units 8 & 9 by 41 and 44 months respectively. ***In case the Contractor fails to achieve successful completion of Trial Operation within specified time period as per the Project Completion Schedule due to delay on his part, then the Owner shall levy liquidated damages.***

7.2 Time Schedules indicated for various activities are for the purpose of monitoring to ensure work completion as per Project Completion Schedule. Only the successful completion of Trial Operation of the unit shall be considered for the purpose of levy of Liquidated Damages.

7.3 ***The payment by Contractor or deduction by Owner of any sums under the provision of this clause shall not relieve the Contractor from his obligations to complete the works or from his other obligations under the contract.***

7.4 ***The liability of payment of these liquidated damages by the Contractor will be established once the delay in successful completion of trial operation is established on the part of the Contractor*** *and the* ***Owner shall not be required to take any***

further action like arbitration or approaching the Court of Law for levying the Liquidated damages.

7.5 *Since the Liquidated damages are limited and the same cannot compensate the consequential loss of the Owner due to delay on the part of the Contractor, the Owner reserves the right to get the work done at the risk and cost of the Contractor, in case delay on the part of the Contractor has been established after giving notice to the Contractor, as may be deemed fit in the interest of completing the balance works.*

7.6 *If the Contractor fails to achieve the Trial Operation of the unit within the time period specified in the Project Completion Schedule due to reasons attributable to him then the owner shall levy Liquidated damages on the Contractor @ 1/2% of the contract price for erection, testing and commissioning (excluding insurance charges taxes and duties) along with applicable price variation per week of delay or part thereof subject to the maximum 10% of the contract price for erection, testing and commissioning (excluding insurance charges taxes and duties) along with applicable price variation .*

7.7 *For the purpose of deciding the amount of Liquidated Damages on the erection price, contract price along with applicable price variation (excluding taxes, duties and insurances charges.) as per contact price adjustment shall be considered.*
Further Liquidated Damages for each Unit shall be levied separately and for this purpose, price of one Unit shall be half of the price of both the units.

47. The above clauses are taken from the contract agreement between the appellant and BHEL (Contractor) for erection and commissioning of main Plant package at Chandrapur TPS expansion project 2 X 500 MW. It can be seen from the above clauses that specific provisions have been made for the payment of liquidated damages. It can be seen from clause 10.1 that the liquidated damages have been determined at 1.5% of the contract price for erection, testing and commissioning along with the other applicable price variation. This clause makes it clear that there is a separate provision in the agreement for payment of liquidated damages by the contractor to the appellant. We are in agreement with the ARA that as separate provisions have been made for the payment of liquidated damages, the contract price and liquidated damages are two different aspects completely separable from each other. It has been held by the ARA that liquidated damages would be covered by the entry (e) of clause 5 of Schedule II which reads as follows:-

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

A plain reading of the entry 5(e) reveals that an activity of a person can be categorized under the said entry if the following ingredients are present:-

i) There should be an agreement.

ii) There should be an obligation.

iii) The obligation would be to – a) Refrain from an act; b) tolerate an act or a situation; c) to do an act.

48. We have already arrived at the conclusion that in section 3 of the contract the specific clause – 7 provides for the levy of liquidated damages if the project completion is delayed beyond the scheduled date. This clause leads us to the conclusion that the appellant is in a contractual agreement with the contractor to impose levy of liquidated damages and to accept the amount of liquidated damages in case of the completion of the project beyond the scheduled date. ***Thus, the appellant has tolerated an act or a situation.*** The purpose of payment of liquidated damages is an act of tolerance in the sense that when there is delay in the completion of the project, the appellant is put to certain hardships which he tolerates in return of the payment of liquidated damages. What entry 5(e) provides that any supply of services of tolerating an act is a supply and therefore the impugned transaction is also a 'supply' under the provisions of the CGST Act.

Let us, for support, refer to the definition of 'liquidated damages' given in the Black Law Dictionary which is as under:-

Black's Law Dictionary (Tenth Edition) on page 473 defines Liquidated damages thus:

"An amount contractually stipulated as a reasonable estimation of actual damages to be recovered by one party if the other party breaches. If the parties to a contract have agreed on liquidated damages, the sum fixed is the measure of damages for a breach, whether it exceeds or falls short of the actual damages."

The definition clearly provides that if the parties agree for liquidated damages, the sum fixed is a measure of damages for a breach. In the impugned case, liquidated damages are ***contractually stipulated*** for delay in the completion of the project. The agreement provides that the contractor may pay a certain percentage for the delay. ***In other words, the appellant was well within his rights to provide for the termination of agreement in case of delay in completion of the project. But in the instant case both the parties agreed that such will not be the effect in case of delay.*** The appellant agrees to tolerate the delay done by the contractor in return for payment of liquidated damages. The appellant could have opted for harsh measures like termination of contract but instead it chooses to tolerate the delay in return of payment of money. Therefore, we agree with the ARA that the said act falls under clause 5(e) of Schedule-II of the Act.

49. It is a contention of the appellant that the liquidated damages reduce the value of the main supply by the contractor and the payment of the liquidated damages are a part of the same supplies and it is mere redetermination of the consideration of the same supply. The damages are recovered by the appellant by deducting them from the bill and therefore it is contended that the liquidated damages are a part of the same

supplies and is a mere redetermination of the consideration. But the deduction is mere method of recovering the money but the fact remains that there is a separate agreement for payment of liquidated damages. We agree with the AAR when they say that value of the work done and which is to be paid is not affected by the amount deducted therefrom towards liquidated damages. The consideration remains unchanged and how the amount is recovered would not change the nature of the supply. Also, neither the definition of 'contract price' nor 'contract value' as given in the Agreement refers to the contingency of liquidated damages. Contract price is defined in clause 3.13 (A) as the total lump sum price plus the price variations. This is an independent clause having no relation to the eventuality of liquidated damages, for which as we have said above, a separate clause has been given. The fact that the liquidated damages are recovered from the bill is only a method of payment- the fact that there are two agreements remains unaltered.

It is contended by the appellant that the liquidated damages cannot be treated as an independent supply. However we do not agree with same. When the contract specifically provides for the payment of the damages, it itself manifests that there is a separate contractual agreement between the two parties.

50. The appellant has referred to the principle of 'ejusdem generis' to claim that the words 'refrain from an act' and 'to do an act' as given under entry (e) of clause (5) of Schedule II pre-supposes the voluntary act from the supplier to perform in a particular manner and therefore, acceptance of damage amounts for compensating the loss and it cannot be considered as 'tolerating of an act.' We have already discussed how the impugned activity falls within the expression of 'tolerating an act'. As to the insistence of it not being voluntary in nature, we only say that when both the parties voluntarily agree that once the delay occurs, the damages become due, ***the said becomes nothing but voluntary.***

51. The appellant has referred to certain provisions of the Central Excise Act in support of his contention that liquidated damages reduce the value of original supply. The issue relates to the provision of existing law and not relevant here. The appellant has also referred to certain judgments in the case of Commissioner of Central Excise v. HFCL (Dt.05.02.2014), Victory Electricals 2013 (298) ELT 534 (Tri-LB), M/s Priyaraj Electronics 2016 (6) TMI 873 CESTAT Bangalore, United Telecom 2006 (204) ELT 626 (Tri Bang) wherein it was held that the lesser amount as a result of clause stipulating variation in the price on account of liability to pay liquidated damages would be transaction value liable to levy of excise duty. These judgements relate to the computation of the transaction value and do not deal with the issue of the taxability of liquidated damages. Also, in the impugned case there are specific clauses relating to the levy of liquidated damages, which clearly show the intent of both the parties. The invoices referred to by the AAR clearly shows that the value of the work done remains

unaltered and there is no price variation because of the liquidated damages. For all the above reasons, these judgements are not relevant here.

Having discussed above, the reply of the questions is as under:-

Question 1

Whether GST is applicable on Liquidated Damages in case of
Type 1 i.e. Operation & Maintenance activities
Type 2 i.e. Construction of new power plants or renovation of old plants
Or is applicable in both cases?

Regarding the agreement between Maharashtra State Power Generation Company Limited (Owner) and Bharat Heavy Electricals Limited (Contractor) for Erection & Commissioning of Main Plant Package at Chandrapur T.P.S. Expansion Project 2 x 500 MW, we agree with the finding of the AAR that GST would be applicable on the Liquidated Damages.

Question 2

If GST is applicable, kindly clarify the following related aspects also

a) **Whether the GST on Liquidated Damages is covered under Schedule II entry No 5(e) vide HSN code 9997-Other Services rate 18% is correct or any other entry is relevant?**
We confirm the finding of the AAR that the following schedule entry under the Notification no.11/2017 – Central / State Tax (Rate) [as amended from time to time] for taxable services would cover the impugned levy of liquidated damages –

Sl. No.	Chapter, Section or Heading	Description of Service	Rate (per cent.) [CGST + MGST]
35	**Heading 9997**	Other services (washing, cleaning and dyeing services; beauty and physical well-being services; and other miscellaneous services including services nowhere else classified).	**18% [9% + 9%]**

b) **Liquidated Damages is determined and imposed upon the contractor after in-depth study. In such case, what will be construed as the time of supply. Will it be the period in which delay is occurring or it is the time when decision to impose Liquidated Damages is taken?**
We confirm the observations of the AAR that as the Agreement expressly provides that liability of payment of these liquidated damages by the Contractor will be established once the delay in successful completion of trial operation is established on the part of the Contractor the said would define the time of supply.

c) If some part of delay has occurred before GST roll-out and some part of delay has occurred after GST roll-out, whether GST will be applicable to the Liquidated Damages imposed for entire period of delay or to the period falling after GST roll-out? In case when GST is to be imposed for period after date of GST rollout but due to maximum capping of LD, the amount of LD is calculated at given percentage instead of being period-based, then how GST needs to be levied.

The AAR held that since no precise facts were before them, the section 14 of the GST Act would have to be referred to by the appellant. We agree with the same.

d) **Whether the contractor / vendor will be able to utilize the amount of LD imposed over him as Input Tax Credit subject to satisfying all other conditions?**

We agree with the AAR that the answer to the above is that input tax credit would be admissible subject to the conditions and restrictions as specified in the GST Act and the Rules made thereunder.

In view of the discussion held hereinabove, we pass the following order:

ORDER

(under section 101 (1) of the Central Goods and Services Tax Act, 2017 and the Maharashtra Goods and Services Tax Act, 2017)

For reasons discussed above, we do not find any reason to interfere with the ruling given by AAR, Maharashtra, vide Advance ruling No. GST-ARA-15/2017-18/B-30 dated 08.05.2018.

The appeal stands disposed off in terms of the above order.

Sd/-
RAJIV JALOTA
(MEMBER)

Sd/-
SUNGITA SHARMA
(MEMBER)

Copy to- 1. The Appellant
2. The AAR, Maharashtra
3. The Pr. Chief Commissioner, CGST and C.Ex., Mumbai
4. The Commissioner of State Tax, Maharashtra
5. The Jurisdictional Officer
6. The Web Manager, WWW.GSTCOUNCIL.GOV.IN
7. Office copy

certified True copy

सी. पी. एस. चौहान/C. P. S. CHAUHAN
उप आयुक्त/DEPUTY COMMISSIONER
वस्तु एवं सेवा कर अग्रिम अधिनिर्णय अपील प्राधिकरण, महाराष्ट्र
The Maharashtra Appellate Authority
for Advance Ruling for Goods & Services Tax