

MAHARASHTRA AUTHORITY FOR ADVANCE RULING
GST Bhavan, Old Building, 1st floor, B-Wing, Room No.107, Mazgaon, Mumbai - 400010.

(Constituted under Section 96 of the Maharashtra Goods and Services Tax Act, 2017)
BEFORE THE BENCH OF

(1) Shri. D. P. Gojamgunde, Joint Commissioner of State Tax, (Member)

(2) Ms. Priya Jadhav, Joint Commissioner of Central Tax, (Member)

ARA No.		AD2708240344044
GSTIN Number, if any/ User-id		27AAECM2936N1Z2
Legal Name of Applicant		M/s. Maharashtra State Electricity Transmission Company Ltd.
Registered Address/ Address provided while obtaining user id		C-19, E-Block, Prakashganga, BKC, Bandra, Mumbai provided while obtaining user id Correspondence address different Maharashtra, 400051.
Details of application		GST-ARA, Application No. 31 Dated 04.09.2024
Concerned officer		Deputy Commissioner of SGST, Nodal Division-03 Mandvi, Mumbai
Nature of activity(s) (proposed/present) in respect of which advance ruling sought		
A	Category	Service Provision
B	Description (in brief)	Advance Ruling on applicability of GST on liquidated damages, compensation and penalty arising out of breach of contract or other provisions of law -reg.
Issue/s on which advance ruling required		<ul style="list-style-type: none">➤ Classification of goods and/or services or both➤ applicability of a notification issued under the provisions of the Act➤ determination of the liability to pay tax on any goods or services or both.➤ 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 per reproduced in para 01 of the proceedings.



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" respectively] by M/s. Maharashtra State Electricity Transmission Company Ltd., the applicant, seeking an advance ruling in respect of the following questions.

1. Whether the following can be termed as "supply"?

- a. Liquidated Damages (LD)/Penalty recovered from contractors/suppliers for breach of contract.

- b. Liquidated Damages (LD)/Penalty recovered from contractors/suppliers on Deposit Works/ Outright Contribution Works (ORC).
- c. Forfeiture of Security Deposit or Earnest Money Deposit in case of refusal to accept the work order despite of being Lowest One (L1) or failure of performance by the supplier or contractor.
- d. Old and unclaimed Creditors balance written back to income A/c after Three (03) Years from the date of completion of the contract.
- e. Write back of Old and unclaimed Earnest Money Deposit (EMD) / Security Deposit (SD) to income A/c after Three (03) Years from the date of the completion of the guarantee period as per contract.
- f. Penalty or charges applied for violation of conditions of contract.

2. If the above are decided as "supply", then:

- a. What shall be the time of supply for each of the above items?
- b. What shall be the HSN/SAC Code and rate of GST for such "supplies"?
- c. Whether ITC can be utilized against payment of GST on such supplies?
- d. What shall be the value of supply?

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 any 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, the expression 'GST Act' would mean CGST Act and MGST Act.

1. FACTS AND CONTENTIONS - AS PER THE APPLICANT

1.1 Maharashtra State Electricity Transmission Company Limited ('MSETCL' or 'the Company') is a leading state transmission utility in the country. MSETCL owns and operates largest Electricity Transmission System in the state. The Company is a wholly owned corporate entity of Maharashtra Government incorporated on May 31, 2005 after restructuring and trifurcation of the erstwhile Maharashtra State Electricity Board.

1.2 The company is in the business of Transmission of Electricity. Services by way of transmission of electricity by an electricity transmission utility is exempt from GST under Notification No. 12/2017-CT (R), Sl. No. 25. Hence, the major activities of the company are exempt from GST.

- a. The company engages services of various contractors to construct EHV Substations, EHV Lines etc. As per the Terms & Conditions of the Contract, if the contractor fails to complete all the works within the time frame



stipulated as completion period, the company levies Liquidated Damages/Penalty for breach of contract.

- b. MSETCL also executes Deposit/Outright Contribution (ORC) Works of Govt., Semi- Govt. & Public Utilities like Central Railway, NHSRCL, PWD, NHAI, CIDCO, etc.; as per their specific requirements like Shifting/Height raising of transmission towers/lines, construction of the new substation or/and the Transmission Lines for their dedicated use. As per the Terms & Conditions of Contract, if the Contractor fails to complete all the works within the period stipulated as completion period, the company levy Liquidated Damages/Penalty for breach of contract.
- c. The company also keeps EMD/security deposit to ensure the Work/Performance by the supplier. The company forfeits the EMD/ security deposit in case of non-acceptance of the work order despite being Lowest One (L1) or failure of performance by the supplier or contractor.
- d. The company writes back old and unclaimed Creditors balance to income after three (03) Years from the date of completion of the contract.
- e. The company writes back old and unclaimed Earnest Money Deposit (EMD) / Security Deposit (SD) to income after Three (03) Years from the date of the completion of the guarantee period as per contract.
- f. The company charges a penalty for violation of terms and conditions of the contract.

In the above scenarios, the company wishes to know, if GST is applicable on such cases. If applicable, what would be the rate of GST and time of supply in such cases.

2. STATEMENT CONTAINING APPLICANT'S INTERPRETATION OF LAW

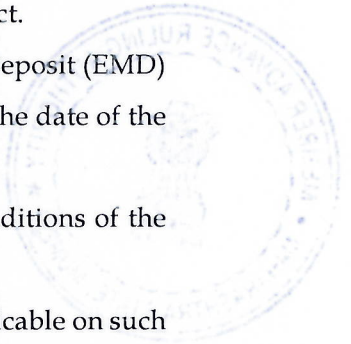
The company has referred following circular and advance rulings to understand the taxability in such cases:

2.1 Circular no. 178/10/2022 - GST dated 3rd August, 2022

The said circular was issued to cover issues of taxability of various issues such as:

- a. Liquidated Damages/Penalty recovered for breach of contract.
- b. Penalty imposed for violation of laws.

After examining the circular, the company is of the view that the cases mentioned at para 1.2 above are not taxable under GST.



2.2 Advance Ruling by Haryana Authority for Advance Ruling in the case of M/s. Rites Limited (Advance Ruling no. HR/ARL/19/2022-23 dated 18/10/2022)

The company has also referred this advance ruling by Haryana AAR in the case of M/s. Rites Limited in which the authority decided that the following activities are outside of purview of GST and not taxable under GST:

- a. Liquidated Damages (LD)/Penalty recovered from contractors/suppliers for breach of contract.
- b. Forfeiture of Security Deposit or Earnest Money Deposit in case of refusal to accept the work order despite of being Lowest One (L1) or failure of performance by the supplier or contractor.
- c. Old and unclaimed Creditors balance written back to income A/c after income after Three (03) Years from the date of completion of the contract.
- d. Write back of unclaimed and Old EMD/SD to income A/c after Three (03) Years from the date of the completion of the guarantee period as per contract.

After careful examination and study of the above ruling, the company is of the view that the above cases are not taxable under GST.



2.3 Submission on comments of Jurisdictional Officer: -

The Jurisdictional Officer has referred Circular No. 178/10/2022-GST, liquidated damages are considered as compensation for tolerating an act or situation, thereby falling within the scope of Section 7(1)(a) read with Schedule II, Entry 5(e) of the CGST Act. Accordingly, such transactions qualify as a "supply" and are liable to GST. However, relevant clauses as in the Circular No. 178/10/2022-GST as regards to Liquidated Damages/Penalty are reproduced as below:

Clause No. 7.1.3-It is argued that performance is the essence of a contract. Liquidated damages cannot be said to be a consideration received for tolerating the breach or non-performance of contract. They are rather payments for not tolerating the breach of contract. Payment of liquidated damages is stipulated in a contract to ensure performance and to deter non-performance, unsatisfactory performance or delayed performance. Liquidated damages are a measure of loss and damage that the parties agree would arise due to breach of contract. They do not act as a remedy for the breach of contract. They do not retribute the aggrieved person. It is further argued that a contract is entered into for execution and not for its breach. The **liquidated damages or penalty**

are not the desired outcome of the contract. By accepting the liquidated damages, the party aggrieved by breach of contract cannot be said to have permitted or tolerated the deviation or non-fulfilment of the promise by the other party.-

Clause No. 7.1.4 In this background a reasonable view that can be taken with regard to taxability of liquidated damages is that where the amount paid as 'liquidated damages' is an amount paid only to compensate for injury, loss or damage suffered by the aggrieved party due to breach of the contract and there is no agreement, express or implied, by the aggrieved party receiving the liquidated damages, to refrain from or tolerate an act or to do anything for the party paying the liquidated damages, in such cases liquidated damages are mere a flow of money from the party who causes breach of the contract to the party who suffers loss or damage due to such breach. **Such payments do not constitute consideration for a supply and are not taxable.**

Further, Haryana Authority for Advance Ruling No. HR/ARL/19/2022-23 dated 18.10.2022 held that GST is not applicable on Liquidated Damages for non-performance/short-performance/delay in performance.

In view of above submission, it is requested to clarify the applicability of GST Liquidated Damages/Penalty for breach of Contract and Violation of Contractual Terms and issue Advance Ruling accordingly.

3. CONTENTION - AS PER THE JURISDICTIONAL OFFICER:

The Applicant seeks an Advance Ruling under the provisions of the Central Goods and Services Tax Act, 2017 ("CGST Act") on the taxability of certain transactions in the light of CBIC Circular No. 178/10/2022- GST dated 03.08.2022. The transactions under consideration are enumerated as follows:

3.1 Whether the following transactions qualify as "Supply" under GST?

- (a) Liquidated Damages (LD)/Penalty Recovered from Contractors/Suppliers for Breach of Contract.** In the case of Advance Ruling of Mahagenco, the Authority for Advance Rulings (AAR) held that Goods and Services Tax (GST) is applicable on liquidated damages. This ruling was subsequently upheld by the AAAR. Accordingly, in the present case, liquidated damages should also be treated as a taxable supply under GST.

As per Circular No. 178/10/2022-GST, liquidated damages are considered as compensation for tolerating an act or situation, thereby falling within the



scope of Section 7(1)(a) read with Schedule II, Entry 5(e) of the CGST Act. Accordingly, such transactions qualify as a "supply" and are liable to GST.

(b) Liquidated Damages (LD)/Penalty Recovered from Contractors/Suppliers on Deposit Works/Outright Contribution Works (ORC)

Similar to (a), these charges are in the nature of consideration for tolerating non-performance or delays, making them a taxable supply under GST.

(c) Forfeiture of Security Deposit or Earnest Money Deposit (EMD) in case of refusal to accept the work order despite being L1 or failure of performance by the supplier or contractor.

Forfeiture of EMD is not a supply unless there is an agreement to tolerate such an act. Since EMD is a security deposit and does not have the character of a consideration, its forfeiture does not amount to a taxable supply.

(d) Old and Unclaimed Creditors' Balance Written Back to Income Account after Three (03) Years from the Date of Completion of the Contract

The act of writing back unclaimed creditors' balances is a mere accounting adjustment and does not involve the supply of goods or services. Consequently, such transactions fall outside the purview of GST.

(e) Write-Back of Old and Unclaimed Earnest Money Deposit (EMD)/Security Deposit (SD) to Income Account After Three (03) Years from the Date of Completion of the Guarantee Period as per Contract.

In alignment with point (c), the mere write-back of unclaimed deposits does not constitute a supply since it lacks the element of consideration for any service rendered. Accordingly, such transactions are not taxable under GST.

(f) Penalty or Charges Applied for Violation of Conditions of Contract

As clarified in Circular No. 178/10/2022-GST, penalties imposed for breach of contractual terms are taxable, as they constitute consideration for tolerating an act. These will be covered under Section 7(1)(a) read with Schedule II, Entry 5(e) of the CGST Act.

3.2 If the above transactions are deemed as "Supply", then:

(a) Time of Supply for Each of the Above Transactions

As per Section 13 of the CGST Act, 2017, the time of supply shall be determined as follows:

- For Liquidated Damages /Penalty (Points a, b, f): The time of supply shall be the earlier of the date of receipt of payment or the date of issuance of an invoice or any other document evidencing the transaction.



- For Forfeited Deposits and Write-Backs (Points c, d, e): Since these transactions do not qualify as a "supply," no GST liability arises.

(b) HSN/SAC Code and Rate of GST:

Pursuant to Circular No. 178/10/2022-GST:

Liquidated Damages, Penalties, and Charges for Contract Violation (Points a, b, f) fall under SAC Code 9997 (Other Services) and attract GST at the rate of 18%.

- Forfeited Deposits and Unclaimed Write-Backs (Points c, d, e) do not qualify as a supply and, therefore, are not subject to GST.

(c) ITC Utilization for Payment of GST on Such Supplies:

Input Tax Credit (ITC) can be availed on inputs and input services used for making taxable supplies. If the penalties or liquidated damages are treated as "supply," ITC can be utilized to pay GST, subject to conditions under Section 16 of the CGST Act, 2017.

(d) Determination of Value of Supply

As per Section 15 of the CGST Act, 2017, the value of supply shall be the total amount received as consideration for the relevant transactions, namely, liquidated damages, penalties, or charges recovered from contractors.

3.3 Conclusion:

- (a) In the case of Advance Ruling of MAHAGENCO, the Authority for Advance Rulings (AAR) held that Goods and Services Tax (GST) is applicable on liquidated damages. This ruling was subsequently upheld by the AAR.

Accordingly, in the present case, liquidated damages should also be treated as a taxable supply under GST.

- (b) Based on the foregoing analysis and the guidance provided under CBIC Circular No. 178/10/2022- GST, the Applicant submits that:

- Liquidated Damages/Penalties for Breach of Contract and Violation of Contractual Terms (Points a, b, f) constitute taxable supplies under GST, attracting a tax rate of 18%.
- Forfeiture of Earnest Money Deposit, Write-Back of Unclaimed Creditors' Balances, and Security Deposit Write-Backs (Points c, d, e) do not qualify as supplies and, therefore, do not attract GST.

4. HEARING

Preliminary e-hearing in the matter held on 14.11.2024. Mr. Ankit Jain C.A. appeared and requested for admission of the application. Jurisdictional Officer Mrs. Sudarshana J. Patil, Deputy Commissioner of the SGST is available.



The application was admitted and called for final e-hearing on 09.04.2025. Mr. Arpit Jain C. A. Authorized Representative, appeared made oral and written submissions. Jurisdictional Officer Mrs. Sudarshana J Patil, Deputy Commissioner of SGST appeared. We heard both the sides.

5. OBSERVATIONS AND FINDINGS:

We have gone through the submissions made by the applicant and the jurisdictional officer.

5.1 Maharashtra State Electricity Transmission Company Limited (hereinafter referred to as 'MSETCL' or 'the Company' or 'the applicant' is a leading state transmission utility in the country. MSETCL owns and operates largest Electricity Transmission System in the state. The Company is a wholly owned corporate entity of Maharashtra Government incorporated on May 31, 2005 after restructuring and trifurcation of the erstwhile Maharashtra State Electricity Board.

5.2 The company is in the business of Transmission of Electricity. Services by way of transmission of electricity by an electricity transmission utility is exempt from GST under Notification No. 12/2017-CT (R), Sl. No. 25. Hence, the major activities of the company are exempt from GST.

5.3 The applicant, is seeking an advance ruling in respect of the various questions. Let us discuss these issues one by one.

1. Whether the following can be termed as "supply"?

a. **Liquidated Damages (LD)/Penalty recovered from contractors/suppliers for breach of contract:** - The company engages services of various contractors to construct EHV Substations, EHV Lines etc. As per the contract Terms & Conditions of Contract, if the contractor fails to complete all the works within the time frame stipulated, the company levies Liquidated Damages/Penalty for breach of contract.

b. **Liquidated Damages (LD)/Penalty recovered from contractors/suppliers on Deposit Works/ Outright Contribution Works (ORC):** - MSETCL also executes Deposit/Outright Contribution (ORC) Works of Govt., Semi- Govt. & Public Utilities like Central Railway, NHSRCL, PWD, NHAI, CIDCO, etc.; as per their specific requirements like Shifting/Height raising of transmission towers/lines, construction of the new substation or/and the transmission lines for their dedicated use. As per Terms & Conditions of the Contract, if the Contractor fails to complete all the works within the period stipulated as completion period, the company levies Liquidated Damages/Penalty for breach of contract.

We have gone through the submission made and Circular no. 178/10/2022-GST dated 3rd August 2022. The relevant portion of this circular on liquidated damages are reproduced as under: -

7.1 Breach or non-performance of contract by one party results in loss and damages to the other party. Therefore, the law provides in Section 73 of the Contract Act, 1972 that when a contract has been broken, the party which suffers by such breach is entitled to receive from the other party compensation for any loss or damage caused to him by such breach. The compensation is not by way of consideration for any other independent activity; it is just an event in the course of performance of that contract.

7.1.4 In this background a reasonable view that can be taken with regard to taxability of liquidated damages is that where the amount paid as 'liquidated damages' is an amount paid only to compensate for injury, loss or damage suffered by the aggrieved party due to breach of the contract and there is no agreement, express or implied, by the aggrieved party receiving the liquidated damages, to refrain from or tolerate an act or to do anything for the party paying the liquidated damages, in such cases liquidated damages are mere a flow of money from the party who causes breach of the contract to the party who suffers loss or damage due to such breach. Such payments do not constitute consideration for a supply and are not taxable.

7.1.5 Examples of such cases are damages resulting from damage to property, negligence, piracy, unauthorized use of trade name, copyright, etc. Other examples that may be covered here are the penalty stipulated in a contract for delayed construction of houses. It is a penalty paid by the builder to the buyers to compensate them for the loss that they suffer due to such delayed construction and not for getting anything in return from the buyers. Similarly, forfeiture of earnest money by a seller in case of breach of 'an agreement to sell' an immovable property by the buyer or by Government or local authority in the event of a successful bidder failing to act after winning the bid, for allotment of natural resources, is a mere flow of money, as the buyer or the successful bidder does not get anything in return for such forfeiture of earnest money. Forfeiture of Earnest money is stipulated in such cases not as a consideration for tolerating the breach of contract but as a compensation for the losses suffered and as a penalty for discouraging the non-serious buyers or bidders. Such payments being merely flow of money are not a consideration for any supply and are not taxable. The key in such cases is to consider whether the impugned payments constitute consideration for another independent contract envisaging tolerating an act or situation or refraining from doing any act or situation or simply doing an act. If the answer is yes, then it constitutes a 'supply' within the meaning of the Act, otherwise it is not a "supply".

In case of MSETCL, if a contractor fails to complete all the works within the period stipulated as per the Terms & Conditions of the Contract., then, MSETCL recovers Liquidated Damages/Penalty for breach of contract. MSETCL is interested in getting services within stipulated time. The contract is for performance of work and not for breach of it. This issue is squarely



covered by explanation given in para 7.1 and 7.1.4 of the aforesaid circular. The principle laid down in the circular is applicable to the penalties in the nature of liquidated damages. Advance ruling order in the case of MAHAGENCO was delivered on 08.05.2018 and AAAR in the said case was delivered on 11.09.2018 whereas the Circular no. 178/10/2022-GST has been issued on 03.08.2022. This circular reflects current understanding of the issue. Hence, we are of the opinion that these activities are not in the nature of a consideration for an activity and hence, would not constitute a supply of service.

c. Forfeiture of Security Deposit or Earnest Money Deposit in case of refusal to accept the work order despite of being Lowest One (L1) or failure of performance by the supplier or contractor: -

The company also keeps EMD/security deposit to ensure the Work/Performance by the supplier. The company forfeits the EMD/ security deposit in case of accept the work order despite of being Lowest One (L1) or failure of performance by the supplier or contractor.

We have gone through the submission made and Circular no. 178/10/2022-GST relevant portion of circular on Forfeiture of Security Deposit or Earnest Money Deposit are reproduced as under: -

7.1.5... Similarly, forfeiture of earnest money by a seller in case of breach of 'an agreement to sell' an immovable property by the buyer or by Government or local authority in the event of a successful bidder failing to act after winning the bid, for allotment of natural resources, is a mere flow of money, as the buyer or the successful bidder does not get anything in return for such forfeiture of earnest money. Forfeiture of Earnest money is stipulated in such cases not as a consideration for tolerating the breach of contract but as a compensation for the losses suffered and as a penalty for discouraging the non-serious buyers or bidders. Such payments being merely flow of money are not a consideration for any supply and are not taxable. The key in such cases is to consider whether the impugned payments constitute consideration for another independent contract envisaging tolerating an act or situation or refraining from doing any act or situation or simply doing an act. If the answer is yes, then it constitutes a 'supply' within the meaning of the Act, otherwise it is not a "supply".

The provisions for Forfeiture of Security Deposit or Earnest Money Deposit in the event of non-acceptance of the work order despite the bid being Lowest One (L1) or failure of performance by the supplier or contractor are in place to discourage non-serious supplier/contractor. The said amounts are recovered by the MSETCL not as a consideration for tolerating the act but as penalties for



dissuading the non-serious supplier/contractor and to discourage and deter such a situation. Therefore, such amounts recovered by the MSETCL are not taxable as consideration is not for any supply of service. Since EMD is a security deposit and does not have the character of a consideration, its forfeiture does not amount to taxable supply.

d. Old and unclaimed Creditors balance written back to income A/c after three years from the date of completion of the contract: -

The company writes back old and unclaimed Creditors balance to income after three years from the date of completion of the contract.

e. Write back of Old and unclaimed Earnest Money Deposit (EMD) / Security Deposit (SD) to income A/c after three years from the date of the completion of the guarantee period as per contract: -

The company writes back old and unclaimed Earnest Money Deposit (EMD) / Security Deposit (SD) to income after three years from the date of the completion of the guarantee period as per contract.

In both the questions, amount unclaimed is written back to income account after three years from the date of contract/completion of the guarantee period as per contract. It is seen that, this transaction is an accounting entry as income and not against any supply. In the above-mentioned transactions, there are no services received or provided by the applicant. The act of writing back unclaimed creditors' balances is a mere accounting adjustment and does not involve the supply of goods or services. Consequently, such transactions fall outside the purview of GST and the mere write-back of unclaimed deposits does not constitute a supply since it lacks the element of consideration for any service rendered. Accordingly, such transactions are not taxable under GST.

f. Penalty or charges applied for violation of conditions of contract.

The company charges a penalty for violation of terms and conditions of the contract.

The basic principles to determine whether recovery of liquidated damages or penalties are taxable supply or not is clearly cited in para 4 to 7 of the Circular No. 178/10/2022-GST which are produced as under;

"4. In Service Tax law, 'Service' was defined as any activity carried out by a person for another for consideration. As discussed in service tax education guide, the concept 'activity for a consideration' involves an element of contractual relationship wherein the person doing an activity does so at the desire of the person for whom the activity is done in exchange for a consideration. An activity done without such a relationship i.e., without the express or implied contractual reciprocity of a consideration would not be



an 'activity for consideration'. The element of contractual relationship, where one supplies goods or services at the desire of another, is an essential element of supply.

5. The description of the declared service in question, namely, agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act in para 5 (e) of Schedule II of CGST Act is strikingly similar to the definition of contract in the Contract Act, 1872. The Contract Act defines 'Contract' as a set of promises, forming consideration for each other. 'Promise' has been defined as willingness of the 'promisor' to do or to abstain from doing anything. 'Consideration' has been defined in the Contract Act as what the 'promisee' does or abstains from doing for the promises made to him.
6. This goes to show that the service of agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act is nothing but a contractual agreement. A contract to do something or to abstain from doing something cannot be said to have taken place unless there are two parties, one of which expressly or impliedly agrees to do or abstain from doing something and the other agrees to pay consideration to the first party for doing or abstaining from such an act. There must be a necessary and sufficient nexus between the supply (i.e. agreement to do or to abstain from doing something) and the consideration.

6.1 A perusal of the entry at serial 5(e) of Schedule II would reveal that it comprises the aforementioned three different sets of activities viz. (a) the obligation to refrain from an act, (b) obligation to tolerate an act or a situation and (c) obligation to do an act. All the three activities must be under an "agreement" or a "contract" (whether express or implied) to fall within the ambit of the said entry. In other words, one of the parties to such agreement/contract (the first party) must be under a contractual obligation to either (a) refrain from an act, or (b) to tolerate an act or a situation or (c) to do an act. Further some "consideration" must flow in return from the other party to this contract/agreement (the second party) to the first party for such (a) refraining or (b) tolerating or (c) doing. Such contractual arrangement must be an independent arrangement in its own right. Such arrangement or agreement can take the form of an independent stand-alone contract or may form part of another contract. Thus, a person (the first person) can be said to be making a supply by way of refraining from doing something or tolerating some act or situation to another person (the second person) if the first person was under an obligation to do so and then performed accordingly.

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

7. There has to be an express or implied agreement; oral or written, to do or abstain from doing something against payment of consideration for doing or abstaining from such act, for a taxable supply to exist. An agreement to do an act or abstain from doing an act or to tolerate an act or a situation cannot be imagined or presumed to exist just because there is a flow of money from one party to another. Unless there is an express or implied promise by the recipient of money to agree to do or abstain from doing something in return for the money paid to him, it cannot be assumed that such payment was for doing an act or for refraining from an act or for tolerating an act or situation. Payments such as liquidated damages for breach of contract, penalties under the mining act for excess stock found with the mining company, forfeiture of salary or payment of amount as per the employment bond for leaving the employment before the minimum agreed period, penalty for cheque dishonour etc. are not a consideration for tolerating an act or situation. They are rather amounts recovered for not tolerating an act or situation and to deter such acts; such amounts are for preventing breach of contract or non-performance and are thus mere 'events' in a contract. Further, such amounts do not constitute payment (or consideration) for tolerating an act, because there cannot be any contract: (a) for breach thereof, or (b) for holding more stock than permitted under the mining contract, or (c) for leaving the employment before the agreed minimum period or (d) for doing something leading to the dishonour of a



cheque. As has already been stated, unless payment has been made for an independent activity of tolerating an act under an independent arrangement entered into for such activity of tolerating an act, such payments will not constitute 'consideration' and hence such activities will not constitute "supply" within the meaning of the Act. Taxability of these transactions is discussed in greater detail in the following paragraphs.

Liquidated Damages

7.1 Breach or non-performance of contract by one party results in loss and damages to the other party. Therefore, the law provides in Section 73 of the Contract Act, 1972 that when a contract has been broken, the party which suffers by such breach is entitled to receive from the other party compensation for any loss or damage caused to him by such breach. The compensation is not by way of consideration for any other independent activity; it is just an event in the course of performance of that contract.

7.1.1 It is common for the parties entering into a contract, to specify in the contract itself, the compensation that would be payable in the event of the breach of the contract. Such compensation specified in a written contract for breach of non-performance of the contract or parties of the contract is referred to as liquidated damages. Black's Law Dictionary defines 'Liquidated Damages' as cash compensation agreed to by a signed, written contract for breach of contract, payable to the aggrieved party.

7.1.2 Section 74 of the Contract Act, 1972 provides that when a contract is broken, if a sum has been named or a penalty stipulated in the contract as the amount or penalty to be paid in case of breach, the aggrieved party shall be entitled to receive reasonable compensation not exceeding the amount so named or the penalty so stipulated.

7.1.3 It is argued that performance is the essence of a contract. Liquidated damages cannot be said to be a consideration received for tolerating the breach or non-performance of contract. They are rather payments for not tolerating the breach of contract. Payment of liquidated damages is stipulated in a contract to ensure performance and to deter non-performance, unsatisfactory performance or delayed performance. Liquidated damages are a measure of loss and damage that the parties agree would arise due to breach of contract. They do not act as a remedy for the breach of contract. They do not retribute the aggrieved person. It is further argued that a contract is entered into for execution and not for its breach. The liquidated damages or penalty are not the desired outcome of the contract. By accepting the liquidated damages, the party aggrieved by breach of contract cannot be said to have permitted or tolerated the deviation or non-fulfilment of the promise by the other party.

7.1.4 In this background a reasonable view that can be taken with regard to taxability of liquidated damages is that where the amount paid as 'liquidated damages' is an amount paid only to compensate for injury, loss or damage suffered by the aggrieved party due to breach of the contract and there is no agreement, express or implied, by the aggrieved party receiving the liquidated damages, to refrain from or tolerate an act or to do anything for the party paying the liquidated damages, in such cases liquidated damages are mere a flow of money from the party who causes breach of the contract to the party who suffers loss or damage due to such breach. Such payments do not constitute consideration for a supply and are not taxable.

7.1.5 Examples of such cases are damages resulting from damage to property, negligence, piracy, unauthorized use of trade name, copyright, etc. Other examples that may be covered here are the penalty stipulated in a contract for delayed construction of houses. It is a penalty paid by the builder to the



buyers to compensate them for the loss that they suffer due to such delayed construction and not for getting anything in return from the buyers. Similarly, forfeiture of earnest money by a seller in case of breach of 'an agreement to sell' an immovable property by the buyer or by Government or local authority in the event of a successful bidder failing to act after winning the bid, for allotment of natural resources, is a mere flow of money, as the buyer or the successful bidder does not get anything in return for such forfeiture of earnest money. Forfeiture of Earnest money is stipulated in such cases not as a consideration for tolerating the breach of contract but as a compensation for the losses suffered and as a penalty for discouraging the non-serious buyers or bidders. Such payments being merely flow of money are not a consideration for any supply and are not taxable. The key in such cases is to consider whether the impugned payments constitute consideration for another independent contract envisaging tolerating an act or situation or refraining from doing any act or situation or simply doing an act. If the answer is yes, then it constitutes a 'supply' within the meaning of the Act, otherwise it is not a "supply".

- 7.1.6 If a payment constitutes a consideration for a supply, then it is taxable irrespective of by what name it is called; it must be remembered that a "consideration" cannot be considered de hors an agreement/contract between two persons wherein one person does something for another and that other pays the first in return. If the payment is merely an event in the course of the performance of the agreement and it does not represent the 'object', as such, of the contract then it cannot be considered 'consideration'. For example, a contract may provide that payment by the recipient of goods or services shall be made before a certain date and failure to make payment by the due date shall attract late fee or penalty. A contract for transport of passengers may stipulate that the ticket amount shall be partly or wholly forfeited if the passenger does not show up. A contract for package tour may stipulate forfeiture of security deposit in the event of cancellation of tour by the customer. Similarly, a contract for lease of movable or immovable property may stipulate that the lessee shall not terminate the lease before a certain period and if he does so he will have to pay certain amount as early termination fee or penalty. Some banks similarly charge pre- payment penalty if the borrower wishes to repay the loan before the maturity of the loan period. Such amounts paid for acceptance of late payment, early termination of lease or for pre-payment of loan or the amounts forfeited on cancellation of service by the customer as contemplated by the contract as part of commercial terms agreed to by the parties, constitute consideration for the supply of a facility, namely, of acceptance of late payment, early termination of a lease agreement, of pre-payment of loan and of making arrangements for the intended supply by the tour operator respectively. Therefore, such payments, even though they may be referred to as fine or penalty, are actually payments that amount to consideration for supply, and are subject to GST, in cases where such supply is taxable. Since these supplies are ancillary to the principal supply for which the contract is signed, they shall be eligible to be assessed as the principal supply, as discussed in detail in the later paragraphs. Naturally, such payments will not be taxable if the principal supply is exempt.

Applying these principles, above mentioned recoveries of penalties for violations of conditions of contract made by MSETCL are not consideration for taxable supply.

2. If the above activities are decided as "supply", then:



- a. What shall be the time of supply for each of the above items?
- b. What shall be the HSN/SAC Code and rate of GST for such "supplies"?
- c. Whether ITC can be utilized against payment of GST on such supplies?
- d. What shall be the value of supply?

As all the activities in the instant case are not held to be supply of services, there is no need to answer the question no. 2.

06. In view of the extensive 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- 31/2024-25/B- 208

Mumbai, dt. 28.04.2025

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

1. Whether the following can be termed as "supply"?

- a. Liquidated Damages (LD)/Penalty recovered from contractors/suppliers for breach of contract.

Ans.- Answered in the negative.

- b. Liquidated Damages (LD)/Penalty recovered from contractors/suppliers on Deposit Works/ Outright Contribution Works (ORC).

Ans.- Answered in the negative.

- c. Forfeiture of Security Deposit or Earnest Money Deposit in case of refusal to accept the work order despite of being Lowest One (L1) or failure of performance by the supplier or contractor.

Ans.- Answered in the negative.

- d. Old and unclaimed Creditors balance written back to income A/c after Three (03) Years from the date of completion of the contract.

Ans.- Answered in the negative.

- e. Write back of Old and unclaimed Earnest Money Deposit (EMD) / Security Deposit (SD) to income A/c after Three (03) Years from the date of the completion of the guarantee period as per contract.

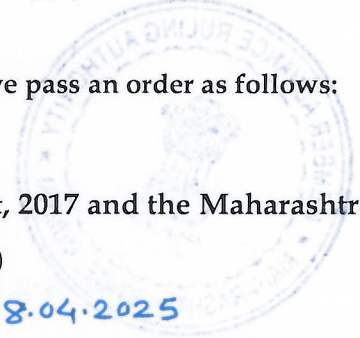
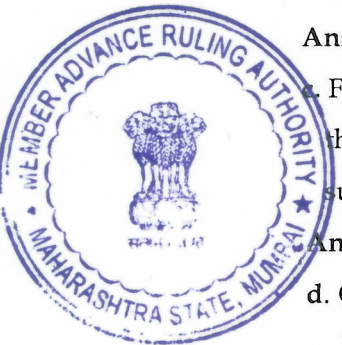
Ans.- Answered in the negative.

- f. Penalty or charges applied for violation of conditions of contract.

Ans.- Answered in the negative.

2. If the above are decided as "supply", then:

- a. What shall be the time of supply for each of the above items?
- b. What shall be the HSN/SAC Code and rate of GST for such "supplies"?

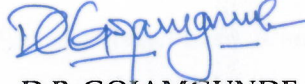


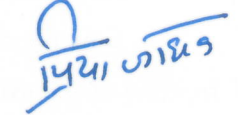
c. Whether ITC can be utilized against payment of GST on such supplies?

d. What shall be the value of supply?

Ans- As all the activities mentioned in question no. 1 are not held as the supply of services, hence, there is no need to answer the question no. 2.




D.P. GOJAMGUNDE
(MEMBER)


PRIYA JADHAV
(MEMBER)

Copy to: -

1. The applicant
2. The concerned Central / State officer
3. The Commissioner of State Tax, Maharashtra State, Mumbai
4. The Pr. Chief Commissioner of Central Tax, Churchgate, Mumbai
5. The Joint commissioner of State Tax, Mahavikas 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. Online facility is available on gst.gov.in for online appeal application against order passed by Advance Ruling Authority.

