MAHARASHTRA AUTHORITY FOR ADVANCE RULING

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

BEFORE THE BENCH OF

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

GSTIN Number, if any/ User-id		27AAECM2935R1ZV
Legal Name of Applicant		MAHARASHTRA STATE POWER GENERATION COMPANY LIMITED
Registered Address/Address provided while obtaining user id		1, 2ND FLOOR, PRAKASHGAD, A K MARG, BANDRA EAST, Mumbai City, Maharashtra, 400051
Details of application		GST-ARA, Application No.15 Dated 30.12.2017
Concerned officer		Deputy Commissioner of State Tax (E-630), LTU-3, Mumbai
Nature of activity(s) (proposed / present) in respect of which advance ruling sought		
A	Category	NOT MENTONED IN THE APPLICATION
B	Description (in brief)	NOT MENTONED IN THE APPLICATION
Issue/s on which advance ruling required		(v) determination of the liability to pay tax on any goods or services or both (vii) whether any particular thing done by the applicant with respect to any goods and/or services or both amounts to or results in a supply of goods and/or services or both, within the meaning of that term
Question(s) on which advance ruling is required		As reproduced in para 01 of the Proceedings below.

PROCEEDINGS

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

The present application has been filed under section 97 of the Central Goods and Services Tax Act, 2017 and the Maharashtra Goods and Services Tax Act, 2017 [hereinafter referred to as "the CGST Act and MGST Act"] by MAHARASHTRA STATE POWER GENERATION COMPANY LIMITED, the applicant, seeking an advance ruling in respect of the following :

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?

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(2)(e) vide HSN code 9997-Other Services rate 18% is correct or any other entry is relevant?*

   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?*

   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.

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?

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

02. FACTS AND CONTENTION – AS PER THE APPLICANT

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

"Background

Maharashtra State Power Generation Company Limited (Mahagenco) is a State Power Utility engaged in generation of power with objective to make Power available to all at affordable rates.

In case of various contracts entered into by the company, there is a clause to deduct Liquidated damages (LD) in case of default by the contractor / vendor to complete the work in time. The LD is deducted in two cases.

Type 1 : Operation & Maintenance activities

In the normal course of business of generation and sale of power, Mahagenco enters in to various contracts with vendor for providing materials and services for operational activities. In this case, if there is delay on the part of the contractor to provide materials / services; Liquidated damages (LD) are deducted from the amount payable to vendor. The LD so deducted is treated as income

Type 2 : Construction of new power plants or renovation of old plants

In this regard, normally the contract is awarded to vendors to build the plant on Turnkey basis. Normally the contracts are awarded in three parts, supply of materials, erection & commissioning and Civil work. As per terms and conditions, the period of completing the contract is fixed. When plant construction is completed, the actual time taken for completion of contract is calculated. If there is delay in completing the contract, the assessment regarding party responsible for delay is made. If the delay is on account of contractor, then Liquidated damages (LD) are calculated as per contract terms and levied upon the contractor.

In accounting, the LD imposedis reduced from the total project cost while capitalizing the asset.Because of delay in the execution of work, the cost of project increases on account of Interest During Construction (IDC) and other administrative overheads. In such situation, LD helps in mitigating the impact of higher costs in form of IDC and administrative charges. Moreover, the contract entered into is for the purpose of construction of plant. There is no explicit agreement between the company and the contractor wherein the company is intending to supply service of tolerance of delay. The delay is neither desired by the company nor by the contractor but to impress upon the contractor to adhere to the timelines, LD clauses are inserted. However, if the delay occurs on account of vendors / contractors, LD is levied upon them. Since, it was never the intention of the company to get its supplies/project delayed nor the contractors want to make delay and thereby causing company to tolerate it, the position of terming the LD as a consideration towards a service provided by the company to the contractor requires clarification.

For the sake of better understanding, clauses relating liquidated damages from one of the contracts pertaining to erection, testing and commissioning is reproduced below –

"7.0LIQUIDATED DAMAGES FOR DELAY IN ERECTION, TESTING AND COMMISSIONING

7.1 The Contractor shall strictly adhere to the Project completion schedule to achieve the trial operation in accordance with the project completion schedule. In case the Contractor fails to achieve successful completion of Trial Operation 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."

Similar clauses are there in supply, civil and structural work of the contract.

Submission dt.08.02.2018

I. STATEMENT OF FACTS

1. The Maharashtra State Power Generation Company Ltd (hereinafter referred to as the applicant) is engaged in generation of power with object of making power available on affordable rates.

2. The applicant 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 applicant has awarded the contract to M/s. BHARAT HEAVY ELECTRICALS LIMITED for the purpose of erection, testing & commissioning of main plant package.
3. As per the contract, the contractor is required to commence the trial operation of unit-8 and unit-9 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 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 the 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.

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 another contract entered into with various parties. The applicant 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.

II. REASONS FOR APPLICATION BEFORE AUTHORITY

a) To pass a ruling to decide whether the recovery of Liquidated Damages from the invoice of the contractor amounts to supply under Section 7 of the GST Act.

b) In case the GST is payable on the Liquidated Damages, will the rate of GST be classified as a separate supply or will it be classified under the category in which the services of the contractor are classified?

c) 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?

d) 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?

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.

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

III. APPLICANT'S INTERPRETATION:

a) Liquidated Damages reduces the value of main supply:

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 applicant. The applicant relies upon the following judgments:

a) **Commissioner of Chandigarh v/s. M/s. HFCL 2015-(11)-TMI-893-CESTAT**

b) **M/s. Victory Electricals Ltd. 2013-(298)-ELT-534**

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

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).

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 where in 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**."*

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'.

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 applicant.

b) Since as per the applicant's interpretation, tax is not payable, the GST will not be classified in any category of services. At the most it can be classified as supply of service under clause 5(e) of Schedule-II which is as follows:

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

c) If it is classified under Schedule-II of clause 5(e), the HSN code 9997, will attract GST @ 18%.

d) The Liquidated Damages is payable when the delay occurs on account of fault of the contractor. This fact needs to be established after determining all the facts and discussions with the contractor. The CBEC vide Circular No. 144/13/2011 dated 18/07/2011 has clarified that the services are completed only when the auxiliary activities for the purpose of raising invoice has also been completed. The para 2 of the Circular is reproduced below:

"2. These representations have been examined. The Service Tax Rules, 1994 require that invoice should be issued within a period of 14 days from the completion of the taxable service. The invoice needs to indicate inter alia the value of service so completed. Thus, it is important to identify the service so completed. This would include not only the physical part of providing the service but also the completion of all other auxiliary activities that enable the service provider to be in a position to issue the invoice. Such auxiliary activities could include activities like measurement, quality testing, etc. which may be essential pre-requisites for identification of completion of service. The test for the determination whether a service has been completed would be the completion of all the related activities that place the service provider in a situation to be able to issue an invoice. However, such activities do not include flimsy or irrelevant grounds for delay in issuance of invoice."

Thus, the Ancillary work is required to be completed for the completion of service. In this case, the ancillary work i.e. discussion with the contractor is required to be completed before the amount is deducted. Therefore, as per the interpretation of the applicant, the time of supply is the time when both the persons agree for the purpose of deduction of Liquidated Damages.

e) As per Section 31 of the GST Act, the invoice can be raised only when the supply of service is completed. As mentioned above, the supply of service is completed, when discussion with the contractor is completed and he has agreed for deduction of Liquidated Damages.

f) The contractor and vendor will be entitled to the credit if any, payable on the Liquidated Damages as the expense is incurred in the course or furtherance of business. Therefore, it is an input service used by him in the course of supplying the services. The interpretation given for para (b) to (f) is without prejudice to our interpretation that no GST is payable, as the deduction of Liquidated Damages does not amount to supply of any services.

Additional submission by the applicant on 27.02.2018

In addition to the re-submissions made on certain portion of our application for advance ruling, the applicant would like to submit the following additional submissions in support of its view: -

1) Determination of Transaction value.

a. 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."

As per the following judgements the Transaction value should be after considering the amount of Liquidated Damages and hence the duty is payable after considering the amount of Liquidated Damages:

1. *COMMR. OF C. EX., CHANDIGARH-I Versus H.F.C.L. (WIRELESS DIVISION) 2015 (11) TMI 893 - CESTAT NEW DELHI*
2. *FACTORY ELECTRICALS LTD 2013 (298) E.L.T. 534 (Tri. - LB)*
3. *M/s. Priyaraj Electronics Ltd. Versus Commissioner of Central Excise Bangalore (2006 (5) TMI 873 - CESTAT BANGALORE.*
4. *UNITED TELECOM LTD 2006 (204) E.L.T. 626 (Tri. - Bang.)*

b. Under GST law section 15(1) of the CGST act,

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. The transaction value is which actually paid or payable hence we can say that the ratio of the above cited judgements can also be applied to the section 15(1) of the CGST Act,2017 and it can

be concluded that resultant price after Liquidated Damages would be the transaction value under section 15(1) of the CGST Act,2017.

2) **Further it is also submitted that primary intention is not to 'tolerate' an act or a 'situation'.**

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.

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.

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

3) 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.

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.

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.'

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.

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.

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.

4) Revised amount in case of renegotiation will be the amount of consideration

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.***

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/GST will be payable on the renegotiated amount.

Additional submission on 07.03.2018

1. We thank you very much for patient hearing on 28.02.2018 on the above application. As submitted during the hearing following additional submission/documents are submitted: -

   i) **Manner of Recovery.**

   As directed, a specimen running bill raised by M/s Bharat Heavy Electricals Limited, bearing no. MS/PW/9515/13/1027(89) is attached as Annexure -1. 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 applicant 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 applicant.

   ii) **The amount not retained for toleration of Act.**

During the hearing the query regarding taxability under the toleration of an act was discussed. It was submitted that 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 applicant had attached one of the contracts with M/s BHEL as specimen. It was submitted that it was 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:

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: -

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.

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.

iii) **The fact is also evident from the provision of Section 15(2) of the CGST Act,2017.**

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 supply. They will not be considered as a separate supply of toleration of an act. The penalty will be leviable for breach of any condition of contract. The penalty as per statutory provision is 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 amount received for tolerating an act.

2. Liquidated damages are recovered for compensating the loss 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.

It has been consistently held that liquidated damage is to compensate the person for loss suffered by him. The amount of loss suffered by appellant due to delay as mentioned in the contract. 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.

3. The entry in 5(e) of CGST Act, 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;*

It was mentioned during hearing 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. The contract will not be in the form of compensation of a loss suffered by recipient of service. In this 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.

The above submission shall be considered while deciding the application.

03. CONTENTION – AS PER THE CONCERNED OFFICER

The submission of the jurisdictional authority is as follows –

"Comments against questions/issues on which Advance Ruling Required:

1) Whether GST is applicable to LD in case of Type 1 i.e. Operation & Maintenance activities. Type 2 i.e. Construction of new power plants or renovation of old plants	GST is applicable to liquidated Damages (LD) in both type of cases As LD is treated as consideration by Appellant which is supply

	under Schedule II entry no. 5(2)(e)of MGST Act.
2) If GST is applicable, kindly clarify the following related aspects also (a) Whether the GST on LD is covered under Schedule II entry No 5(2) (e) vide HSN code 9997-other services rate 18% is correct or any other entry is relevant?	a) GST on LD is covered under Schedule II entry no. 5(2) (e), GST rate will be as per the contract on which LD is imposed.
(b) LD 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 LD is taken?	b) Time of Supply of Services in GST is when any 2 of following conditions are fulfilled; i. Date of Service invoice raised ii. Date of Service performed iii. Date of payment received Section 13(2) of MGST Act.
(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 LD imposed for entire period of delay or to the period falling after GST roll-out? In case when GST 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.	c) As above
(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?	d) Contractor/Vendor may get input Tax Credit subject to satisfying all other conditions.

04. HEARING

The case was taken up for preliminary hearing on dt.06.02.2018 when Sh. S. S. Gupta, Sh. Karan Awtani, Sh. Ashutosh Shukla (all Chartered Accountants) attended alongwith Sh. Pankaj Sharma, Chief General Manager (Accounts) and Sh. Vijay Chitlange, General Manager (Accounts) and submitted that their Advance Ruling (AR) application is for query covered in section 97(2) of the AR provisions. However, they were informed that their application was not proper in all respects and specifically details as required in Column No. 16 were not properly given and therefore, they were requested to submit proper application latest by dt.12.02.2018 otherwise their application is liable for rejection without further notice. Jurisdictional Officer, Sh. S.D. Page, Dy. Commissioner of State Tax (E-630), Large Tax Unit-3, Mumbai also appeared and stated that they do not have objection to admission of application of Advance Ruling and would be submitting details as required at the time of final hearing.

Fresh application of Advance Ruling was received on dt.08.02.2018 and the applicant was called for a final hearing on dt.28.02.2018. Sh. S. S. Gupta, Sh. Karan Awtani, Ashutosh Shukla attended alongwith Sh. Vijay Chitlange and Ms. Madhuri Mundlye, (Assistant General Manager) and made revised submission which are taken on record. They orally reiterated their contention as made in the revised application submitted on dt.08.02.2018. They also submitted that they would be submitting, latest by dt.08.03.2018, copies of invoices evidencing recovery of liquidated damages. Jurisdictional Officer Sh. S.D. Page also appeared and made written submission.

05. OBSERVATIONS

We have gone through the facts of the case. The questions posed are in respect of 'liquidated damages'. We find that the applicant contends that these damages being towards

deficiency of services and reduce the original consideration and will not be considered as separate service covered by the term 'Obligation to tolerate an act or a situation'. To understand the appropriateness of this contention, we would have to go through the facts. There is also a sample agreement provided but before that let us revisit the brief introduction as given by the applicant as under -

- *Maharashtra State Power Generation Company Limited (Mahagenco) is a State Power Utility engaged in generation of power with objective to make Power available to all at affordable rates.*
- *In case of various contracts entered into by the company, there is a clause to deduct Liquidated damages (LD) in case of default by the contractor / vendor to complete the work in time. The LD is deducted in two cases.*

  Type 1 : Operation & Maintenance activities

  In the normal course of business of generation and sale of power, Mahagenco enters in to various contracts with vendor for providing materials and services for operational activities. In this case, if there is delay on the part of the contractor to provide materials / services; Liquidated damages (LD) are deducted from the amount payable to vendor. The LD so deducted is treated as income

  Type 2 : Construction of new power plants or renovation of old plants

  In this regard, normally the contract is awarded to vendors to build the plant on Turnkey basis. Normally the contracts are awarded in three parts, supply of materials, erection & commissioning and Civil work. As per terms and conditions, the period of completing the contract is fixed. When plant construction is completed, the actual time taken for completion of contract is calculated. If there is delay in completing the contract, the assessment regarding party responsible for delay is made. If the delay is on account of contractor, then Liquidated damages (LD) are calculated as per contract terms and levied upon the contractor.
- *In accounting, the LD imposed is reduced from the total project cost while capitalizing the asset. Because of delay in the execution of work, the cost of project increases on account of Interest During Construction (IDC) and other administrative overheads. In such situation, LD helps in mitigating the impact of higher costs in form of IDC and administrative charges. Moreover, the contract entered into is for the purpose of construction of plant. There is no explicit agreement between the company and the contractor wherein the company is intending to supply service of tolerance of delay. The delay is neither desired by the company nor by the contractor but to impress upon the contractor to adhere to the timelines,*

As mentioned earlier, the above is the applicant's understanding. What the applicant says needs to be supported by the agreement. We see that a Contract 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 has been provided. The agreement consists of a set of various documents such as Letter of Award, Letter of Acceptance, etc. However, the first thing that we notice is that the agreement pertains to the period before the GST Act came into force. The applicant has submitted that the agreements are usually entered on the lines similar to the agreement submitted for our perusal. The clauses as are relevant for determination of the issue at hand could be had a look at -

- **Agreement dt.30.03.2010**

  Whereas the Owner is desirous that certain ancillary services should be provided by the Contractor, viz. Erection, Testing & Commissioning of Main Plant equipments consisting of Steam Generator, Steam Turbine and Generator, C&I, Electrical equipments and other Auxillary Equipments for Chandrapur T.P.S. Expansion Project – 2x500 MW and in furtherance of above, the Owner has issued a Letter of Award No. DG/Chandrapur Expn. Proj./MP/Erection & Commg./3415 dated 25.07.2008 and Letter No. DG/CHN 2x500MW./MP/Erection/0452 dated 21.01.09 (Amendment-1) to the Contractor for Erection, Testing & Commissioning of Main Plant equipments consisting of Steam Generator, Steam Turbine and Generator, C&I, Electrical equipments and other Packages for Chandrapur T.P.S. Expansion Project – 2x500 MW for the sum of Rs.2,75,28,20,000.00 (Rupees Two Hundred Seventy Five Crore Twenty Eight Lakh Twenty Thousand only) (hereinafter called "the Contract Price") which is accepted by the Contractor vide their Letter No. MS-4-08-0007/0008 dated 31.07.2008 and Letter No. MS-4-08-0007/0008 dated 09.02.2009.

  Now this Contract Agreement witnesseth as follows:

  3) In consideration of the payments to be made by the Owner to the Contractor as hereinafter mentioned, the Contractor hereby covenants with the Owner to provide the goods and to remedy defects therein in conforming in all respects with the provisions of the Contract.

  4) The Owner hereby covenants to pay the Contractor in consideration of the provision of the goods and the remedying of defects therein, the Contract Price or such other sum as may become payable under the provisions of the Contract at the times and in the manner prescribed by the Contract.

- **Letter of Award dt.25.07.2008**

2.0 SCOPE OF CONTRACT

2.1 The scope of contract shall include receipt of materials/ equipment, unloading and handling at site, transportation to stores, storage, checking of materials in stores, transportation of material to erection site, carrying out preparatory works prior to erection of material, insurance, erection, testing and commissioning, final painting and putting into operation of the Main Plant Equipments supplied by BHEL under supply contract vide LOA under ref.13. . The scope of works against this LOA shall also include unloading and handling over of Mandatory Spares to MahaGenco's stores after receipt in good condition & joint verification at site by the contractor and the owner.

2.2 All consumables, paints, chemicals,, equipments, piping and all temporary works required for hydraulic test, boiler light up, alkali boil out, acid cleaning, steam blow off etc. for carrying out erection, testing & commissioning of the unit at site are to be arranged by the Contractor within the scope. The Contractor shall also be responsible for arranging auxiliary steam required during unit commissioning within the scope.

3.0 CONTRACT PRICE

3.1 The contract price for Erection, Testing & Commissioning of Main Plant equipments is Rs.2784280800.00 (Rupees Two Hundred Seventyeight Crores Fortytwo Lakhs Eighty Thousand Eight Hundred only) as detailed below.

		Amount
i)	Price for Erection, Testing & Commissioning including Comprehensive Insurance charges. :	Rs. 2478000000/-
ii)	Service tax on E & C at 12.36% :	Rs. 306280800/-
	Total Price for Erection, Testing & Commissioning of Main Plant Equipments including Comprehensive Insurance	Rs.2784280800/-

(Rupees Two Hundred Seventyeight Crores Fortytwo Lakhs Eighty Thousand Eight Hundred only)

4.0 CONTRACT PRICE ADJUSTMENT / VARIATION

4.1 The price for erection, testing & commissioning excluding insurance charges and taxes & duties, shall be subjected to price variation as per the Terms of Bid Specification under ref.1 with Base Indices as on March 08. The price variation shall be subjected to a ceiling of (+/-) 20% of the contract price for Erection, Testing & Commissioning excluding taxes & duties and insurance charges.

4.2 In case the contract period is required to be examined beyond the cut off dates for reasons attributable to the Contractor, for making payments towards price variation, the Owner shall select the indices in the P.V. formula either by restricting their value to contractual cut off date or the actual indices prevailing at that time whichever is lower. In case the contractual period is extended for the reasons attributable to the Owner in such an event the price variation shall be payable on the extended period of contractual cut off dates, based on the prevailing price indices.

8.0 PROJECT COMPLETION SCHEDULE

8.1 The Contractor shall so organize his resources and perform his works as per the Project Completion Schedule enclosed herewith so as to achieve synchronization and Trial Operation of the Unit as below.

	Period in months from the zero date	
	Unit-1	Unit-2
Unit Synchronization :	38 (Thirtyeight)	41 (Fortyone)
Trial Operation :	41 (Fortyone)	44 (Fortyfour)

9.0 ZERO DATE

9.1 The zero date for the contract for Erection, Testing & Commissioning against this Letter of Award shall be the zero date as per the Letter of Award for supply of Main Plant Equipment under ref.13.

10.0 LIQUIDATED DAMAGES

10.1 <u>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</u> 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.

11.0 TERMS OF PAYMENT

11.1 The Owner shall make progressive payment as and when they are due as per the payment schedule / Billing Break-up approved by the Owner. The Contractor should note that financing of this project shall be covered under loan from Rural Electrification Corporation (REC), Mumbai. The Invoices along with the documents listed in the relevant clauses of terms of payment shall be submitted by the Contractor to the General Manager (Gen. Project), Maharashtra State Power Generation Co. Ltd. (MahaGenco) Chandrapur TPS. Expansion Project, Post- Urja Nagar, Chandrapur – 442 404, Dist. Chandrapur for all the payments against this lOA, except for the payment of advance and comprehensive insurance charges.

11..1.2 Service Tax shall be paid on submission of Invoices along with an undertaking from BHEL Unit that the amount of Service Tax claimed in the said Invoice shall be deposited with Government Authorities as per Service Tax Act. M/s. BHEL shall also furnish the certificate on quarterly basis from Head of Finance from the respective Unit certifying that the Service Tax claimed from MahaGenco has been deposited with the respective Tax Authorities.

- **Amendment No.1 dt.11.01.2009**

In view of the discount offered by BHEL, Para 3.1 of Erection LOA under ref. 1 is amended as below.

The contract price for Erection, Testing & Commissioning of Main Plant equipments is Rs.2,75,28,20,000/- (Rupees Two Hundred Seventy Five Crore Twenty Eight Lakh Twenty Thousand only) as detailed below.

Sr.No.	Particulars	Amount in Rs.
i)	Price for Erection, Testing & Commissioning including Comprehensive Insurance charges. :	Rs. 2,45,00,00,000/-
ii)	Service tax Including applicable Cess @12.36% :	Rs. 30,28,20,000/-
	Total Price for Erection, Testing & Commissioning of Main Plant Equipments including Comprehensive Insurance	Rs.2784280800/-

(Rupees Two Hundred Seventy Five Crore Twenty Eight Lakh Twenty Thousand only)

- Section 2 – General Conditions of Contract

3.0 DEFINITION OF TERMS

3.9 "works" shall mean labour and services and complete erection, testing and commissioning of the equipment handling, unloading, storage etc. as per contract.

3.13 (A) Contract Price shall mean the total lump-sum price named in the contract for providing all services as per the scope of the contract including all applicable taxes, duties & insurance charges.

(B) **Total Contract Price means the contract price plus the price variations, if any.**

3.14 "Contract value" shall mean that part of the contract price which is properly apportionable to the plant or work in question having regard to the state, conditions and topographical location of the plant, the amount of work done and all other relevant circumstances and disregarding any changes that may have occurred since the date of contract in the cost of executing the works.

16.0 DEDUCTIONS FROM TOTAL CONTRACT PRICE

16.1 The Owner shall claim all costs, damages or expenses that the Owner may have paid, for which under the contract the Contractor is liable.

The Owner to the Contractor shall bill all such claims regularly as and when they fall due. Such bills shall be supported by appropriate documents or explanations, to enable the Contractor to properly identify such claims. **Such claims shall be paid by the Contractor within 15 (fifteen) days of the receipt of the corresponding bills and if not paid by the Contractor within the said period, the Owner may then deduct the amount from any monies due or becoming due by him to the Contractor under this contract or any other contract. These amounts may be recovered by actions of law or otherwise, if the Contractor fails to satisfy the Owner of such claims.**

21.0 CONTRACTOR'S DEFAULT

21.1 If the contactor shall neglect to execute the works as defined in the contract with due diligence and expedition or shall refuse or neglect to comply with any reasonable orders given to him in writing by the Engineer in connection with the works or shall contravene the provisions of the contract, the Owner may give a notice in writing to the contractor to make good the failure, neglect or contravention complained off. Should the contactor fail to comply with the notice within 30 (thirty) days from the date of service thereof, then and in all such cases, the owner shall be at liberty to employ other workmen and forthwith execute such part of the works as the contractor may have neglected to do or, if the owner shall deem fit, it shall be lawful for him, without prejudice to any other right he may have under the contract, to take the works wholly or in part out of the contactor's hand and re-contract with any other person or persons to complete the works or any part thereof.

The owner shall be entitled to retain and apply any balance which may otherwise be due to the contactor or such part thereof, as may be necessary, to the payment of cost of executing the said part of the works or of completing the works. If the cost of executing the said part of the works or of completing the works thereof as aforesaid shall exceed the balance due to the contractor, the contractor shall pay such excesses. Such payment of excess amount shall be independent of the liquidated damages for delay which the contactor shall have to pay if the completion of works is delayed.

In addition, such action by the owner as aforesaid shall not relieve the Contactor of his responsibility to pay liquidated damages for delay in completion of the works as defined in this contract.

51.0 OWNERSHIP OF PLANT

51.1 The plant and equipment supplied by the Contractor pursuant to the contract shall become the property of the Owner at whichever is the earlier of the following times viz.

i) When the plant and equipment is delivered / despatched pursuant to the contract.

ii) When the contractor has been paid any sum to which he may become entitles in accordance with the provisions of this contract.

iii) Plant is otherwise taken over by the owner in terms of contract.

- **<u>Section 3 – Special Conditions of Contract</u>**

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 **<u>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</u>** 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.

13.5 PAYMENT TOWARDS ERECTION, TESTING AND COMMISSIONING

13.5.1 10% (ten percent) advance on the price for Erection, Testing & Commissioning of Equipments alongwith applicable service tax & education cess but excluding insurance charges shall be paid within 30 (thirty) days of fulfillment of the following by the Contractor.

i. ……

13.5.2 85% (Eighty five percent) i.e (95% of the contract price for erection, testing & commissioning of equipments less 10% advance adjustment) of the price for erection, testing & commissioning along with applicable 100% Service tax & education cess as per agreed billing break up shall be paid on prorata basis.

……

The following documents shall be submitted ……

i) Invoice 1 Original + 2 copies

……

13.5.3 The next 5% (five percent) of the price for erection, testing & commissioning shall be released within 30 days on Successful Completion of Performance Guarantee test. In case Performance Guarantee test is delayed beyond the contractual completion schedule, (to meet the needs of the Owner) the last 5% shall be released on the scheduled date of performance guarantee test against an equivalent bank guarantee valid upto actual satisfactory completion of PG test. The following documents shall be submitted……

i) Invoice 1 Original + 2 copies

13.5.4 PAYMENT TOWARDS MARINE CUM ERECTION INSURANCE CHARGES

13,6.1 100% payment towards Marine-cumErection insurance charges alongwith applicable service tax and education cess, shall be released on submission of following documents ……

i) Invoice 1 Original + 2 copies

A perusal of the above provisions make us observe that the contract price and the liquidated damages are two different aspects. Deduction of one from the other is a mere facilitation towards settlement of the accounts. This manner of giving effect to the obligations under the contract should not be deceptive of the actual intent. We observe so for reasons thus –

1. The agreement says that 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 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.

2. The obligations on the Contractor calling for supply of the deliverables thereunder is one event. This event consisting of a supply occurs first. After occurrence of this event, there is evaluation in terms of whether the supply of the deliverables under the agreement were supplied within the time frame as agreed upon by the Contractor. This evaluation results in either a timely or delayed or a premature performance. The finding of this evaluation when there being a delay, the contingent liability of liquidated damages translates into an actual recoverable liability. This is the second event. What we say has been incorporated in the agreement in the words thus - ***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.***

3. Both the events have their consequences. The first event calls for the payment of a contract price to the Contractor. The second event calls for payment of liquidated damages to the Owner.

4. The manner employed for recovery of the contract price or the liquidated damages would not define what a contract price or the liquidated damages mean.

5. The deduction from the amount as payable to the Contractor is for the purposes of adjustment of the accounts.

6. Though the situation is so, even if the agreement had clauses regarding deductions form the contract price, we are convinced that we wouldn't have had a different opinion than the one as taken above. Both the contract price and the levy of liquidated damages are distinct events.

7. In the present case, we find that even the agreement does not support the act of deduction from the contract price as can be seen thus –

   a. The clause relating to contract price and contract value say thus –

      3.13 (A) Contract Price shall mean the total lump-sum price named in the contract for providing all services as per the scope of the contract including all applicable taxes, duties & insurance charges.
      (B) **Total Contract Price means the contract price plus the price variations, if any.**

      3.14 "Contract value" shall mean that part of the contract price which is properly apportionable to the plant or work in question having regard to the state, conditions and topographical location of the plant, the amount of work done and all other relevant circumstances and disregarding any changes that may have occurred since the date of contract in the cost of executing the works.

      Neither the contract price nor the contract value refer to the eventuality of liquidated damages. Contract price is the total lumpsum price plus the price variations. There is no specific indication as to reduction in the contract price due to the levy of liquidated damages.

   b. The price variations also have been set out in the agreement thus –

      4.0 CONTRACT PRICE ADJUSTMENT / VARIATION
      The price for erection, testing & commissioning excluding insurance charges and taxes & duties, shall be subjected to price variation as per the Terms of Bid Specification under ref.1 with Base Indices as on March 08. The price variation shall be subjected to a ceiling of (+/-) 20% of the contract price for Erection, Testing & Commissioning excluding taxes & duties and insurance charges.

      As can be seen, the price variations to which the contract price would be subjected to makes no reference to the effect of levy of liquidated damages.

   c. There is also a clause about deductions from the contract price thus -

      16.0 DEDUCTIONS FROM TOTAL CONTRACT PRICE
      16.1 The Owner shall claim all costs, damages or expenses that the Owner may have paid, for which under the contract the Contractor is liable.
      The Owner to the Contractor shall bill all such claims regularly as and when they fall due. Such bills shall be supported by appropriate documents or explanations, to enable the Contractor to properly identify such claims. **Such claims shall be paid by the Contractor within 15 (fifteen) days of the receipt of the corresponding bills and if not paid by the Contractor within the said period, the Owner may then deduct the amount from any monies due or becoming due by him to the Contractor under this contract or any other contract. These amounts may be recovered by actions of law or otherwise, if the Contractor fails to satisfy the Owner of such claims.**

A perusal of the above clause suggests that when the Owner incurs certain expenses which should have been borne by the Contractor, there is a separate mechanism of recovery also other than recovery by way of adjustment from the payments to be made to the Contractor.

d. There is also a clause about Contractor's default thus -

21.0 CONTRACTOR'S DEFAULT

21.1 If the contactor shall neglect to execute the works as defined in the contract with due diligence and expedition or shall refuse or neglect to comply with any reasonable orders given to him in writing by the Engineer in connection with the works or shall contravene the provisions of the contract, the Owner may give a notice in writing to the contractor to make good the failure, neglect or contravention complained off. Should the contactor fail to comply with the notice within 30 (thirty) days from the date of service thereof, then and in all such cases, the owner shall be at liberty to employ other workmen and forthwith execute such part of the works as the contractor may have neglected to do or, if the owner shall deem fit, it shall be lawful for him, without prejudice to any other right he may have under the contract, to take the works wholly or in part out of the contactor's hand and re-contract with any other person or persons to complete the works or any part thereof.

The owner shall be entitled to retain and apply any balance which may otherwise be due to the contactor or such part thereof, as may be necessary, to the payment of cost of executing the said part of the works or of completing the works. If the cost of executing the said part of the works or of completing the works thereof as aforesaid shall exceed the balance due to the contractor, the contractor shall pay such excesses. Such payment of excess amount shall be independent of the liquidated damages for delay which the contactor shall have to pay if the completion of works is delayed.

It can be seen from the above that payment of liquidated damages is treated as an independent liability under the contract. It is not to be mixed with other payments due to the Owner from the Contractor.

e. The clause relating to payment towards advance or payment for execution, testing, commissioning also does not require invoices to be considered taking into consideration the liability towards liquidated damages. The invoices to be prepared are in terms of the contract price. And we see that the bills as submitted for our perusal also do not show a bill being raised after considering liquidated damages. The bills are for work done during a particular period and are accompanied by a Certificate which says in a pointwise manner as to how the amounts have been arrived at. On this Certificate, there are some rough workings as made by the applicant which show calculations involving subtractions, one such subtraction being for liquidated damages. However, if we minutely look at the deductions, it is seen thus –

Invoice as raised by the Contractor		**Rough working by the Owner (applicant)**	
1. Boiler & Aux – Unit-9 For the work done during March'13 As per the Annex. Enclosed	375,29,811	37529810 4174816 41704626	
2. Less: Advance @ 10%	37,52,981	3752981	Advance
3. Less: Compln. of P.G. Test(5%)	18,76,491	1876491	Retention
4. Net Billing (4) = (1)-(2)-(3)	319,00,339	759033	Tax
5. Service Tax @12.36% on 90% billing	41,74, 816	5629471	against L.D – 15%
6. Net billing with Service Tax (6) = (4)+(5)	360,75,155	12017976	Deductions
		29686680	N. pay

What the above rough calculations as shown by the applicant reveal is that the amount shown as Net and Tax is acceptable to the applicant. It is only while making the payment of the above acceptable amount that the

applicant deducts some amount towards liquidated damages. Thus, the value of the work done and which is to be paid is not affected by the amount deducted therefrom towards liquidated damages. Thus, the consideration for the work done remains unaltered. How the amount for the work done is discharged between the parties should not bother the Taxmen as these are the adjustments between the parties. For the Taxman, what would matter is the value for the work done. And once this valuation is properly done and tax liability thereon discharged, whether this value is paid partially or not paid at all would not be a concern from the taxation perspective but a matter between the contracting parties.

The above treatment by both the parties reveals two things –

- It negates the contention that since recovery of Liquidated Damages is a part of the contract, the value of the main supply reduces to the extent of Liquidated Damages deducted by the applicant.
- It confirms the position as brought out in the agreement clauses that recovery of Liquidated Damages is an independent liability.
- The manner of deducting the amount of Liquidated Damages from the amount payable to the Contractor does not alter the valuation of the deliverables or the supplies made under the agreement.

8. We have to observe that the applicant is not the supplier in terms of the amounts received as contract price or contract value. The GST Act under clause (a) of section 95 defines that an Advance Ruling is in relation to the supply of goods or services or both being undertaken or proposed to be undertaken. However, the exercise of looking at the contract price or contract value becomes necessary as the applicant has relied on the following provision in sub-section (1) of section 15 of the GST Act to claim that the reduction of the amount towards Liquidated Damages amounts to reducing the value of the supply. It also becomes necessary as the applicant informs that the Liquidated Damages so deducted are treated as income of the applicant. The provision reads thus-

Value of taxable supply.
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.*

In the present case, the agreement clauses as reproduced above, the invoice as prepared and the calculations, as reproduced above, as made by the applicant reveal that there are no two opinions between the contracting parties that the value of the supply as received by the applicant does not include the liquidated damages. There are measures

CHAIRMAN, ADVANCE RULING AUTHORITY MAHARASHTRA STATE MUMBAI

identified in the agreement to arrive at the contract value or the invoice value. The words *"price actually paid or payable"* in respect of the value of the goods or services supplied do not come into play in the present set of facts of deduction of the amount towards liquidated damages. We have seen above that this deduction does not mean that the price actually paid is less. The income of the applicant is recovered by deducting from the outgoings of the applicant. This would not translate into making the income of the applicant as being the other party's lesser income or the applicant's lesser expenditure. We have seen above that the contract price and the liquidated damages are independent events.

9. We find that the applicant has argued that it was never the intention of the company to get its supplies/project delayed nor the contractors want to make delay and thereby causing company to tolerate it. In this regard, we have to observe that if an agreement has such a clause and if the eventuality actually happens then the GST Act has provided for such an eventuality in terms of the provision as follows :

SCHEDULE II [See section 7]
ACTIVITIES TO BE TREATED AS SUPPLY OF GOODS OR SUPPLY OF SERVICES
5. Supply of services
The following shall be treated as supply of services, namely:—
(e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;

In the present case, the agreement provides that ***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.*** Thus, the act of delayed supply has happened. The same is being tolerated by an additional levy in the nature of liquidated damages. The agreement has also provided that ***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.*** This provision just ensures that the obligations under the contract are fulfilled. The facts are much obvious that the empowerment to levy liquidated damages is for the reason that there has been a delay and the same would be tolerated, but for a price or damages. The impugned income though presented in the form of a deduction from the payments to be made to the Contractor is the income of the applicant and would be a supply of 'service' by the applicant in terms of clause (e) of para 5 of Schedule II appended to the GST Act.

10. The applicant has referred to a few case laws and provisions to draw inferences in support of the contentions as made. We have gone through these case laws and find that the facts are not in *pari-materia* to the case before us. In H.F.C.L (cited supra), the CESTAT, New Delhi quoted the observation of the Larger Bench in Victory Electricals (cited supra) that that wherever the assesse, as per terms of the contract between the parties and on account of delay in delivery of manufactured goods, is liable to pay a

lesser amount than the generally agreed price as a result of a clause stipulating variation in the price, on account of liability to "liquidated damages" irrespective of whether the clause is titled "penalty" or "liquidated damages", the resultant price would be the "transaction value" and such value shall be alone liable to levy of excise duty, at the applicable rate. In the present case, there are no such clauses as would tantamount to reducing the contract price or the contract value of the supplies of goods or services or both as made by the Contractor. In fact in the present case, the levy of liquidated damages is specifically identified as an independent levy. We have seen that the Contract Price Variation clause in the impugned agreement, does not provide for variation on account of liquidated damages. And above all, we have seen the intent as being reflected in the treatment of the parties as not to alter the value of the work done and the tax liability on such value while making deductions therefrom. The reliance on case laws is, therefore, not helpful to the applicant. The facts of the instant case before us being distinct, we would refrain from discussing the other points in support of the contention.

Having seen as above, we refer to the questions as posed for our decision.

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?

We have not been provided with separate agreements in respect of the situations posed above. The facts of each agreement and the attending circumstances would have to be seen to provide an answer. We can only answer in terms of 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 that has been provided for our perusal. In terms of the aforesaid agreement, 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(2)(e) vide HSN code 9997-Other Services rate 18% is correct or any other entry is relevant?

We would be constrained to restrict the answer to this question in terms of only the agreement placed before us. We have observed above that the impugned levy of liquidated damages would be covered by clause (e) of para 5 of Schedule II appended to the GST Act.

To answer the question as regards the schedule entry and the tax rate applicable, we find that there is no specific schedule entry in the Notification no.11/2017 – Central / State Tax (Rate) [as amended from time to time] for taxable services and the Notification no.12/2017 – Central / State Tax (Rate) [as amended from time to time] for services exempt from GST. A reference to the Annexure about Scheme of Classification of Services as appended to the Notification no.11/2017 – Central / State Tax (Rate) [as amended from time to time] reveals thus –

S. No.	Chapter, Section, Heading, Group	Service Code (Tariff)	Service Description
700	Heading 9997		Other services
716	Group 99979		Other miscellaneous services
720		999794	Agreeing to tolerate an act
722		999799	Other services nowhere else classified

In view of the above, 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 would be constrained to restrict the answer to this question in terms of only the agreement placed before us. The question would stand answered by the following clauses in the agreement –

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 – 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.

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 .

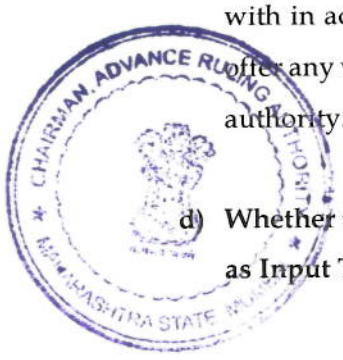
7.7 **For the purpose of deciding the amount of Liquidated Damages on the erection price, contract price along with applicable price variation (excluding taxes, duties and insurances charges.) as per contact price adjustment shall be considered**.
Further Liquidated Damages for each Unit shall be levied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

All the above clauses reveal that the levy of liquidated damages is not when the delay is occurring. 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. This 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 question is based on some incorrect presumption owing to which the applicant seems to have adopted some method of deduction of liquidated damages from the payments to be made to the contractor. We are afraid that no such strategy of deducting or of capping can be inferred from the agreement clauses. We would be constrained to restrict the answer to this question in terms of only the agreement placed before us. Sub-section (1) of section 13 of the GST Act provides that the liability to pay tax on services shall arise at the time of supply. If the Contractor fails to achieve the Trial Operation of the unit within a specified time period which falls under the GST regime then levy of liquidated damages would be attracted and this levy would attract the GST levy. In view thereof, as discussed in the answer to the Q.2(b), the agreement clauses would have to be referred to. Since no precise facts are before us, the section 14 of the GST Act would have to be referred to by the applicant.

Further in respect of the liquidated damages if any collected/received under the previously applicable service tax regime before coming into effect of GST, would be dealt with in accordance with the then existant provisions under applicable laws and we do not offer any view with regard to the previous service tax regime being out of the scope of present authority.



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?**

The above question is not answered as the proper person to ask the above question would be the contractor / Vendor and not applicant.

06. In view of the deliberations held hereinabove, we 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- 15/2017-18/B- 30 **Mumbai, dt.** 8/5/2018

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

Q.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?

A.1 *In terms of the aforesaid agreement, GST would be applicable on the Liquidated Damages.*

Q.2 *If GST is applicable, kindly clarify the following related aspects also -*

Q.2(a) *Whether the GST on Liquidated Damages is covered under Schedule II entry No 5(2)(e) vide HSN code 9997-Other Services rate 18% is correct or any other entry is relevant?*

A.2(a) *In terms of the aforesaid agreement, schedule entry no.35 of 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.*

Q.2(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?*

A.2(b) *In terms of the aforesaid agreement, the clauses reveal that the levy of liquidated damages is not when the delay is occurring but 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. This would define the time of supply.*

Q.2(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.*

A.2(b) *Sub-section (1) of section 13 of the GST Act provides that the liability to pay tax on services shall arise at the time of supply. In view thereof, as discussed in the answer to the Q.2(b), the agreement clauses would have to be referred to. Since no precise facts are before us, the section 14 of the GST Act would have to be referred to by the applicant.*

Q.2(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?*

A.2(d) The above question is not answered as the proper person to raise this question would be the contractor /Vendor and not applicant.

PLACE – Mumbai
DATE – 15/2/22

B. V. BORHADE
(MEMBER)

PANKAJ KUMAR
(MEMBER)

CERTIFIED TRUE COPY

ADVANCE RULING AUTHORITY
MAHARASHTRA STATE, MUMBAI

Copy to:-

1. The applicant
2. The concerned Central / State officer
3. The Commissioner of State Tax, Maharashtra State, Mumbai
4. The Chief Commissioner, GST & Central Excise, GST Bhavan, Churchgate, Mumbai
5. The Jurisdictional Commissioner of Central Tax