

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		27AABCB1518LIZS
Legal Name of Applicant		Bajaj Finance Limited
Registered Address/ Address provided while obtaining user id		3rd Floor, Panchshil Tech Park, Viman Nagar, Pune-411 014
Details of application		GST-ARA, Application No. 22 Dated 09.05.2018
Concerned officer		State Tax Officer (VAT-C-707) Pune
Nature of activity(s) (proposed / present) in respect of which advance ruling sought		
A	Category	Service Provision
B	Description (in brief)	<ul style="list-style-type: none">The Applicant is a non-banking financial institute and is inter alia engaged in providing various types of loan to the customers such as auto loans, loan against the property, personal loan, consumer durable goods loan, etc.In case of delay in repayment of dues by the customers, the Applicant collects penal/default interest as an additional interest for the number of days of delay in terms of the agreements executed by the customers.
Issues on which advance ruling required		(ii) applicability of notification issued under the provisions of the Act (iii) determination of time and value of supply of 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 02 of the Proceedings below.

PROCEEDINGS

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

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

i) *Whether the Penal Interest is to be treated as interest for the purpose of exemption under Sr. No. 27 of Notification No. 12/2017 Central Tax (Rate) dated 28.06.2017, Sr. No. 27 of Maharashtra State Notification No. 12/2017-State Tax (Rate) dated 29.06.2017, and Sr. No. 28 of Notification No. 9/2017 Integrated Tax (Rate) dated 28.06.2017?*

ii) *If the answer to the above is negative, whether the activity of collecting penal interest by the Applicant would amount to a taxable supply under the GST regime?*

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

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

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

1. The Applicant is a non-banking financial company and is inter alia engaged in providing various types of loan to the customers such as auto loans, loan against the property, personal loans, consumer durable goods loans, etc. All these loans are interest bearing loans.
2. The Applicant inter alia enters into agreements with borrower/customers for providing loans to them. The loan agreements provide for repayment of the outstanding dues/Equated Monthly Installments (EMI) through cheque/ Electronic Clearing System (ECS) National Automated Clearing House ('NACH) or any other electronic or clearing mandate. The illustrative copies of loan agreement entered into between the Applicant and the customers are collectively enclosed as **Annexure-1**.
3. The installment of a loan is computed taking into consideration the amount of loan, duration of the loan and the amount of EMI that would be payable by the customer to the Applicant. EMI paid by the customer is a fixed amount payable at a specified date. EMI are used to pay-off both interest and principal amount.
4. In case of delay in repayment of EMI by the customers, the Applicant collects penal/default interest (hereinafter referred to as "**penal interest**") as an additional interest for the number of days of delay in terms of the agreements executed by the customers. The penal interest is calculated at a fixed percentage on the overdue loan amounts of the customer. The percentage of penal interest varies from customer to customer, and generally ranges between 2% to 4% per month depending on the product. The illustrative copies of customer account statement reflecting the penal interest collected by the Applicant are collectively enclosed as **Annexure-2**.

5. The relevant extract of clauses of a sample auto loan agreement in respect of penal interest is reproduced below for ease of reference:

"1. DEFINITIONS AND ABBREVIATIONS,

r. "**Penal Charges**" shall mean and include overdue charges on non payment of installment on the due date.

.....

II. TERMS OF THE LOAN:

3. The Borrower agrees and confirms that:

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

(a) for continuing non payment of amount due, a penalty not exceeding 3% per month on amount due calculated on pro-rata basis from due date till actually paid as per clause B of the schedule.

..... Emphasis Supplied

6. The amount of penal interest collected from the customers are accounted by the Applicant in its core accounting platform i.e. SAP under General Ledger Code 60000150.
7. Under the GST (implemented from July 01, 2017), the Applicant is of the view that penal interest collected from the customer is in the nature of additional interest, and therefore, the same is not subjected to GST levy. However, given the ambiguity on taxability of penal interest under the GST law, as an abundant caution, the Applicant is filing the present application for Advance Ruling.

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

2. **Issue(s) requiring Advance Ruling**

- 2.1 Based on the above, the Applicant would like to seek an advance ruling, on the following questions:

- i) Whether the Penal Interest is to be treated as interest for the purpose of exemption under Sr. No. 27 of Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017, Sr. No. 27 of Maharashtra State Notification No. 12/2017-State Tax (Rate) dated 29.06.2017, and Sr. No. 28 of Notification No. 9/2017-Integrated Tax (Rate) dated 28.06.2017?
- ii) If the answer to the above is negative, whether the activity of collecting penal interest by the Applicant would amount to a taxable supply under the GST regime?

3. **Applicant's Interpretation**

- 3.1 With respect to the questions framed above, the Applicant has analyzed the relevant legal provisions in the ensuing paras.

A. **Penal Interest is an additional interest on the overdue loan installment, and therefore, would be exempt from GST. To further emphasis, penal interest should be treated as a part of interest, and therefore, would be exempt from GST.**

- A.1 Under the GST regime, the taxable event shall be the supply of goods or services. The scope of the term 'supply' is provided under Section 7 of the CGST Act, which includes all forms of supply of goods and/or services such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made

for a consideration in the course or furtherance of business and importation of services. It also includes activities specified in Schedule I made or agreed to be made without a consideration.

- A.2 Vide Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017, the Central Government, in view of powers conferred by Section 11 of the CGST Act, has notified various intra-state supply of services which are exempt from CGST. The Serial No. 27 of the said Notification, inter alia, grants exemption to the services by way of extending loans, in so far as the consideration is represented by way of interest. The relevant portion of the said Exemption Notification is reproduced herein below:

Sl.	Chapter, Section, Heading, Group or Service Code (Tariff)	Description of Services	Rate (per cent.)	Condition
(1)	(2)	(3)		
27	Heading 9971	Services by way of (a) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services):	Nil	Nil

- A.3 Similar exemption has been granted by the respective State Governments in respect of the State Goods and Services Tax (SGST) leviable on intra-state supplies. The Serial No. 27 of Maharashtra State Notification No. 12/2017-State Tax (Rate) dated 29.06.2017 provides for the exemption to the above said services provided in the State of Maharashtra. Further, similar exemption has been granted by the Central Government vide Serial No. 28 of Notification No. 9/2017-Integrated Tax (Rate) dated 28.06.2017, in respect of the Integrated Goods and Services Tax ("IGST") leviable on inter-state supply of the above said services.

- A.4 In view of the above, it is submitted that services of providing loans is exempt under the GST regime, in so far as the consideration of the said services is represented by way of interest. In other words, interest on loans is not subjected to GST levy.

- A.5 In this regard, attention is kindly brought towards the definition of the term 'interest provided under clause (zk) of para 2 of the above said Exemption Notifications, which reads as under:

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

- A.6 The above definition clearly states that interest' means interest payable in any manner in respect of any moneys borrowed or debt incurred. It is submitted in this regard that the Penal Interest collected by the Applicant is an additional interest for the delay in payment of loan installment beyond the due date. It is relevant to note here that while computing the EMI/installment amount, the interest is factored in the EMI on the assumption that all the installments would be paid on time. However, in case, there is any delay in payment of the installments, the interest for the period of delay is not included in the EMI / installment amount, and is therefore charged separately from the customers as penal interest. It is therefore submitted that the penal interest collected by the Applicant, which represents the time value of money for the period of delay in making payment of installment, is nothing but additional interest on loan. Therefore, the penal interest shall be given similar treatment as that of the principal interest which is factored in EMI / installment amount, and hence, the same shall also be covered under the definition of interest.

- A.7 It is further submitted that the amount of overdue loan installment is virtually a new loan transaction given to the borrower/customer for the period of delay, the consideration for which is the penal interest charged on such overdue loan installment. It is submitted in this regard that where the Applicant grants loan to a customer for a specified duration of time, it earns interest on such loan, which represents consideration for use of money for that specified period of time. Similarly, when the customer delays the payment of installment of loan beyond the due date as provided in the agreement, the Applicant levies additional interest (which is termed as "Penal Interest") for use of the money beyond the stipulated period of time by the borrowers/customers. The manner of calculation of such Penal Interest substantiates that the penal interest is the time value of money, in as much as the same is calculated at a fixed rate per annum on the overdue loan installments for the period of delay. In this regard, the sample working of the penal interest is already enclosed as Annexure-3.

- A.8 Hence, in view of the above, it is submitted that the penal interest collected by the Applicant is nothing but interest on loans only.

- A.9 It is relevant to note that the term interest has been discussed at length by various Courts holding that interest is the return or compensation for the use or retention by one person, of a sum of money belonging to or owed to another. In this regard, reliance is placed on the Supreme Court judgment in the case of **Central Bank of India vs. Ravindra**, reported at 2002 (1) SCC 367.

- A.10 Reliance in this regard is also placed on the following judgments of the Hon'ble Madras High Court, wherein it was held that any amount paid over and above the principal amount was interest:

- **Edupuganti Pitchayya and Ors. vs. Gonuguntla Venkata Ranga Row**, AIR 1944 (Mad) 243
- **V. Srinivasachariar vs. Conjeevaram Hodgsonpet Dharamarakshaka Nidhi Ltd**, 1940 APR (Mad) 937



- A.11 From the above judgments, it comes out clearly that any consideration received for money is nothing but interest only. In the present case, the Penal Interest charged by the Applicant is the additional interest for usage of the amount of overdue loan installment by the borrowers/customers for additional time beyond the stipulated time period. This additional interest received is therefore in the nature of interest only. Therefore, the above said judgments explaining The meaning of the term 'interest' would be applicable in the present case as well.
- A.12 It is further submitted that the nomenclature given to a particular. object/transaction would not affect its taxability. It is a settled principle of law that nomenclature alone would not determine the nature of transaction. In this regard, reliance is placed on the decision of the Hon'ble Supreme Court in the case of Moped India Limited reported at 1986 (23) ELT 8 (SC). It is therefore submitted that even though, the interest for the use of money (i.e. the overdue loan installment) by the defaulting customers for an additional time period beyond the due date is being termed as "penal interest", the same would not change its nature from being interest".
- A.13 In view of the above, it is submitted that the Penal Interest collected by the Applicant, which represents the consideration for time value of money, is interest only, and therefore, shall be exempt from GST under the Exemption Notifications referred to in para A.2 & A.3 above.
- A.14 Without prejudice to the above, it is submitted that in view of clause (d) of sub-section (2) of Section 15 of the CGST Act, the penal interest being an interest/penalty for delayed payment of any consideration for a supply would be included in the value of that supply, which is interest. Therefore, any treatment given to the main consideration (i.e. interest) shall also be equally applicable to such amount (i.e. penal interest). Hence, even by applying the said provision in the present case, the penal interest so collected by the Applicant would be having the same tax treatment as in the case of interest, and therefore, it would be exempt from GST under the Exemption Notifications referred to in para A.2 & A.3 above.
- B. **Without prejudice to the above, assuming that Penal Interest is not interest, the same shall not be treated as a consideration for any supply.**
- B.1 Without prejudice to the above, assuming without accepting that Penal Interest is not interest, the same shall not be treated as a consideration for any supply. It is submitted that the term 'consideration is defined under Section 2 (31) the CGST Act as under:
 "(31) "consideration" in relation to the supply of goods or services or both includes
 (a) any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;
 (b) the monetary value of any act or forbearance, in respect of, in response to, or for the inducement of the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government."
- B.2 Since the above definition is an inclusive one, the meaning of the term 'consideration will have to be understood from various external aids, including the natural meaning given in various dictionaries, meaning given to the term in rulings by various forums, etc.
- B.3 It is submitted that the concept of consideration has been derived from the Latin phrase "quid pro quo" which means "something for something". It is a well settled principle that "where there is no consideration, there is no contract".
- B.4 Reference in this regard is made to the definition of the term 'consideration provided in Section 2(d) of the Indian Contract Act, 1872 (hereinafter referred to as '**the Contract Act**'), which reads as under:
"When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise."
- B.5 Furthermore, it is submitted that various dictionaries define the term 'consideration as follows:
BLACK LAW DICTIONARY
Consideration means something which is of value in the eye of law, moving from the plaintiff., either of benefit to the plaintiff or of detriment to the defendant.
WEBSTER DICTIONARY
Something of value given or done in exchange for something of value given or done by another, in order to make binding contract; inducement for a contract,
- B.6 From the above discussed meaning of the term 'consideration', it can be said that consideration would necessarily mean "quid pro quo", i. e. Something in return. It is a benefit which must be bargained for between the parties, and is essential reason for a party entering into a contract. Further, the consideration for an activity must be at the desire of the other person.
- B.7 In the present case, the penal interest is collected by the Applicant on account of default committed by the customers in making repayment of overdue loan installments in time. Therefore, it is submitted that the penal interest is not recovered by the Applicant in lieu of, or, in return for any activity performed by the Applicant.
- B.8 The Applicant would like to bring your attention to clause (d) of sub-section (1) of Section 7 of the CGST Act, which states that the expression supply also includes the activities to be treated as supply of goods or supply of services as referred to in Schedule II. Entry 5 of Schedule II specifies the list of activities to be treated as supply of services, which inter alia contains clause (e), which ' reads as agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act'..

- B.9. It is submitted in this regard that the expression to tolerate an act' used in the above clause. should be understood to cover instances where the consideration is being charged by one person. in order to allow another person to undertake any particular activity. These are the cases, where it is clear at the very inception that the intention of one party is to undertake an activity and the other party shall allow the same without any hindrance. Such a contract is entered with an intention to allow the other person to carry out an activity, and not as a penalty/ line to deter such person to repeat the act in future. Even if such activity is repeated in future, there is no intention to deter the happening of the same,
- 3:10. The expression agreeing to tolerate in act' cannot be construed to include situations wherein liquidated damages/ penalty is charged by a party for defaults' breach committed by other party under the contract. In fact, the very intention of such penal clauses is to create a deterrent effect and ensure that the defaults/violations are not repeated by the erring party,
- B.11. It is further submitted that the word 'obligation used in Clause (e), Entry 5 of Schedule II of the CGST Act, indicates the need for the existence of the desire in the person for whom the activity is done. In other words, when the service recipient requests the service provider to tolerate an act/ situation and the service provider obliges to tolerate for a consideration, then such a contractual relationship will get covered by the said clause of Schedule II of the CGST Act. In such situation, the service provider binds himself to act in a particular manner as desired by the service recipient and there is consensus ad idem between the contracting parties to this effect.
- B.12. Contrary to the above, the penal interest is collected only on happening of any event of default by the customers in making the payment of loan installments. It is submitted in this regard that the intention of the parties entering into loan agreement is to grant/avail loan and not to tolerate non-payment of loan dues. Therefore, it would be erroneous to assume that the party granting loan (i.e. the Applicant) are entering the loan agreement to tolerate the default of the borrowers/customers. Therefore, merely because of existence of the clause of penal interest in the contract for breach of the performance of the contract, it does not mean that the parties have entered into the contract for the penal interest. Hence, it is submitted that there is no obligation on the Applicant to tolerate the act of the delay in payment of loan installments by the customer/borrower.
- B.13. Therefore, the activity of collecting penal interest does not even fall under the ambit of the deemed supply under Clause (e), Entry 5 of Schedule II of the CGST Act. Hence, the penal interest collected for the delay in payment of loan installment cannot be treated as consideration for any supply, and accordingly, is not taxable under the GST regime.

Without prejudice to the above, penal interest is in the nature of liquidated damages/penalty.

Without prejudice to the above submissions, it is further submitted that the penal interest collected by the applicant is merely in the nature of penalty/liquidated damages for default in loan repayments by the customers, which would not be subjected to GST levy.

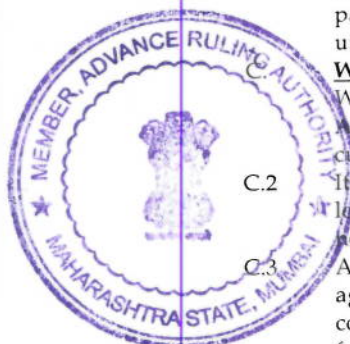
- C.2. It is submitted in this regard that liquidated damages/ penalty are merely compensation for making good the loss suffered by a contracting party due to breach of terms of the contract by other contracting party. There is no additional benefit given under the main contract of supply of service, in return for the liquidated damages.
- C.3. Attention in this regard is brought towards Section 73 of the Contract Act, which statutorily allows the aggrieved party to recover damages from the defaulting party in case of default or breach of terms of the contract by such party to the contract. Relevant portion of Section 73 of the said Act is extracted hereunder for ready reference:

Section 73. Compensation of loss or damage caused by breach of contract-

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

... .. Emphasis Supplied

- C.4. In view of the above, it is submitted that the liquidated damages / penalty charged for breach of contract are legal consequences of the defaulting party, and therefore, the said amount shall not be treated as consideration for any activity. It is further submitted that the consideration for breach of contract, in the form of liquidated damages, cannot be treated as the consideration for the contract per se, hence, would not be taxable under the GST regime:
- C.5. It is submitted that even internationally, it is a settled position that the damages received in compensation for termination or breach of a contract cannot be treated as a supply and therefore not subjected to GST/ VAT.
- C.6. In this regard, reference is made to GSTR 2001/4, issued by the Australian Tax Office (ATO), explains the GST treatment of court orders and out-of-court settlements. In the said ruling at Para 73, it has been clarified that the damages are the most common form of remedy arising out of the termination or breach of contract. The damage, loss or injury, being the substance of the dispute, cannot in itself be characterized as a supply made by the aggrieved party. This is because the damage, loss or injury in itself does not constitute a supply under the provision of Australian GST
- C.7. Reference is further made to GSTR 2003/11, pertaining to "payment on early termination of a lease of goods. It has been clarified therein that a payment received to compensate the lessor for damage or loss flowing from early termination as a result of a default by the lessee is not consideration for a supply, even though the lessor brings the lease to an end by exercising the right to terminate the lease. The Ruling further provides that in such cases, there will be no taxable supply because a payment for genuine damages, which is not



consideration for any earlier or current supply, cannot be said to be made in connection with any supply. The lessor merely exercises his right to terminate and the payment is in the nature of damages for the lessee's breach of the lease which gave rise to the lessor's right to terminate. Thus, in the above Ruling issued under Australian GST, it has been clarified that mere payment of an amount under a damages claim is not a 'supply' and hence, GST is not payable on such payment.

- C.8 Further, **GST Determination No. 2005/6** has been issued to answer the question as to whether a club, association, trade union, society or co-operative (referred to as "association in the Determination") makes a supply when it imposes a non-statutory fine or penalty on a member for a breach of the association's membership rules. The said GSTD clarifies that there is no supply made by an association when it imposes a fine or penalty on its member for a breach of its membership rules, and the payment of the fine or penalty is therefore not a consideration for a supply and hence not subjected to GST. It has been clarified in the above GSTD that if the true nature of fine or penalty is a punishment and/or to act as a deterrent, it does not accord with that nature to suggest that there is a supply to the member in return for its payment.
- C.9 Further, in **New Zealand case S65 (1996) 17 NZTC 7408**, the Determination stated that an association, in accepting the payment of fine or penalty, does not enter into an obligation with the particular member to tolerate the misconduct, but rather is fulfilling its obligation to all members to enforce the rules. The member does not gain rights additional to those which are already enjoyed by virtue of being a member. That is, upon payment of the fine or penalty, the member continues to enjoy the same rights and privileges and it follows that the association is required to continue to provide the benefits of membership. In this sense, it cannot be said that the association 'makes' a supply where it already has a pre-existing obligation to continue to provide the benefits of membership.
- C.10 In view of the above discussed rulings, the Applicant would like to submit that the very purpose of liquidated damages / penalty is to retribute or make good, the loss incurred by a person because of a default, non-compliance, etc. of the other person. Such liquidated damages/penalty may be in relation to some other supply of service or goods which would have a separate consideration and would be subject to certain terms and conditions to certain terms and conditions. When such terms and conditions are not fulfilled, the defaulting party is obligated to make good the loss by paying liquidated damages. Such liquidated damages/penalty cannot itself become consideration for continuing with the main supply of service/goods by terming the same as towards tolerating the acts of the defaulting party.
- C.11 In view of the above, it is submitted that the penal interest collected by the Applicant, is in the nature of liquidated damages/penalty received from the borrowers/customers for defaults/ breach committed by them by defaulting in loan repayments.

Hence, in view of the above submissions, even if it is assumed that the penal interest collected by the Applicant, is not interest on loans, then, the same being in the nature of liquidated damages/penalty, would not be treated as a consideration for any supply, and therefore, will be outside the levy of GST.

Conclusion

- 3.2. Based on the above provisions and discussions, the Applicant is convinced that the activity of collecting the penal interest will not be subjected to GST, in as much as the same is in the nature of interest on loans, which is exempt from GST. Further, even if it is assumed that the penal interest collected by the Applicant, is not interest on loans, then, the same being in the nature of liquidated damages/penalty, would not be treated as a consideration for any supply, and therefore, will be outside the levy of GST.

Additional submissions on 06.08.2018

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

- A. **The Applicant is only engaged in the business of lending/financing to customers, and the amount charged as penal interest is nothing, but interest on loans, which is exempt from GST.**

- A.1 The Applicant is a Non-Banking Financial Company, inter alia engaged in providing various types of loans to the customers such as auto loans, loan against property, personal loan, consumer durable goods loan, etc. It is submitted that interest on loans have always been kept outside the levy of tax.

Position prior to GST

From 10.09.2004 upto 18.04.2006 - Interest on loans was excluded from Value of Taxable Service under Section 67 of the Finance Act, 1994

- A.2 Lending as a service was first time brought into the ambit of Service Tax, with effect from 10.09.2004, by an amendment in the definition of banking and other financial services' under Section 65(12) of the Finance Act, 1994. The amended definition read as under:

**(12) "banking and other financial service" means --*

- (a) the following services provided by a banking company or a financial institution including a non-banking financial company or any other body corporate or any other person, namely:*

- (i) financial leasing services including equipment leasing and hire-purchase;*

.....

.....

- (ix) other financial services, namely, lending issue of pay order, demand draft, cheque, letter of credit and bill of exchange, transfer of money including telegraphic transfer, mail transfer and electronic transfer, providing bank guarantee, overdraft facility, bill discounting facility, safe deposit locker, safe vaults, operation of bank accounts;"*

..... Emphasis Supplied

- A.3 At the same time, with effect from 10.09.2004, an amendment was carried out in the Service Tax Valuation provisions to exclude interest on loans' from the value of taxable service under clause (viii) of Explanation I to Section 67 of the Finance Act, 1994. The relevant provision as inserted with effect from 10.09.2004 is extracted herein below:

SECTION 67. Valuation of taxable services for charging service tax. – For the purposes of this Chapter, the value of any taxable service shall be the gross amount charged by the service provider for such service rendered by him.

Explanation 1. – For the removal of doubts, it is hereby declared that the value of a taxable service, as the case may be includes, -

... ..

but does not include –

... ..

(viii) interest on loans."

... Emphasis Supplied

From 19.04.2006 upto 30.06.2012 -- Interest on loans excluded from Value of Taxable Service under Rule 6(2)(iv) of the Service Tax (Determination of Value) Rules, 2006

- A.4 With effect from 19.04.2006, the valuation provisions contained in the Finance Act, 1994 were shifted to the Service Tax (Determination of Value) Rules, 2006. Accordingly, with effect from 19.04.2006, the interest on loans was excluded from the value of taxable service under clause (iv) of Rule 6(2) of the said Rules. The said provision is extracted herein below for reference:

***6. Cases in which the commission, costs, etc. will be included or excluded. –**

(1) Subject to the provisions of section 67, the value of the taxable services shall include, -

(2) Subject to the provisions contained in sub-rule (1), the value of any taxable service, as the case may be, does not include –

(iv) interest on loans."

... Emphasis Supplied

From 01.07.2012 upto 30.06.2017 - Interest on loans was exempted under Negative List clause (n) of Section 66D of the Finance Act, 1994.

- A.5 With effect from 01.07.2012, the Negative List regime was introduced, wherein all services, except those covered in the negative list or exemption notification, were taxed. The interest on loans was exempted under Negative List clause (n) of Section 66D of the Finance Act, 1994, which read as under;

"SECTION 66D. Negative list of services. – The negative list shall comprise of the following services, namely: –

(n) services by way of –

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

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

..... Emphasis Supplied

- A.6 In view of the above provisions, it is submitted that since beginning, interest on loans have been kept outside the levy of service tax, and therefore, any amount charged as interest was not taxable in the pre-GST regime.

Position under the GST regime

- A.7 Under the GST regime, interest on loans are exempted from payment of CGST under Serial No. 27 of the Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017. Similar exemption has been granted by the respective State Governments for the SGST leviable on intra-state supplies (refer Serial No. 27 of Maharashtra State Notification No. 12/2017 State Tax (Rate) dated 29.06.2017). The relevant portion of the said Exemption Notification is reproduced herein below:

Sl.	Chapter, Section, Heading, Group or Service Code (Tariff)	Description of Services	Rate (per cent.)	Condition
(1)	(2)	(3)		
27	Heading 9971	Services by way of (a) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services):	Nil	Nil

- A.8 In view of the above, it is submitted that even under the GST regime, services of providing loans are exempt, in so far as the consideration of the said services is represented by way of interest.

- A.9 In this regard, attention is kindly brought towards the definition of the term interest provided under clause (zk) of para 2 of the above said Exemption Notifications, which reads as under:

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

..... Emphasis Supplied

- A.10 The above definition clearly states that interest' means interest payable in any manner in respect of any moneys borrowed or debt incurred. This would not only include the normal interest charged on loan installments, but also the interest charged for the delayed payment of such loan installments.



- A.11. In the present case, the Applicant is primarily engaged in the business of lending/financing. As a consideration for lending/financing, the Applicant charges interest from the customers at a particular rate, for the period for which such loan is granted. The principal and interest amount on such loan is repaid by the customers by way of equated monthly installments (hereinafter referred to as EMI) over the tenure of loan. Accordingly, while computing the EMI, the Applicant charges and factors pro-rata interest payable on each due date, on the underlying assumption that the customers would not default in payment of the EMI on the due dates. However, in case of any default, the Applicant charges additional interest for the number of days of default. This interest is commonly known as penal/default interest. The sample working of computing the penal interest is enclosed as **Annexure-3** to the application submitted on 09.05.2018 (refer page no. 81, along with page no. 71 to 76). For ease of reference, the following illustration is made to explain the manner of charging penal interest:

S. No.	Particulars	Amount
A	EMI Amount	Rs. 10,000/-
B	EMI Due Date	10th of every month
C	Due Date for the month of June 2018	10th June 2018
D	Interest factored in EMI upto due date	Rs. 3,000/-
E	Actual Date of Payment	30th June 2018
F	Period of Delay/Default	20 days
G	Penal Interest rate	2% p.m.
H	Penal Interest for the period of delay (Rs. 10000 * 2% * 20/30)	Rs. 133/-

- A.12. It is submitted that the amount of overdue loan installment is virtually a new loan given to the borrower/customer for the period of delay, the consideration for which is the penal interest charged on such overdue loan installment. In the above illustration, the overdue loan installment of Rs. 10,000/- is an additional loan given to the customer, for which penal interest is charged, from the date of default till the date of payment of such installment, i.e., from 10th June 2018 to 30th June 2018.

- A.13. It is submitted in this regard that where the Applicant grants loan to a customer for a specified duration of time, it earns interest on such loan, which represents consideration for use of money for that specified period of time. Similarly, when the customer delays the payment of installment of loan beyond the due date as provided in the agreement, the Applicant levies additional interest (which is termed as 'Penal Interest') for use of the money beyond the stipulated period of time by the borrowers/customers. The manner of calculation of such Penal Interest substantiates that it is nothing but the time value of money, in as much as the same is calculated at a fixed rate per annum on the overdue loan installments for the period of delay.

- A.14. It is relevant to note that the position in the GST regime is similar to the position in the pre GST regime. Therefore, reference is made to the Revised Education Guide on Taxation of Services dated 20.06.2012 issued by the CBEC in erstwhile Service Tax regime. Para 4.14.2 of the said Education Guide, clarifies that the negative list clause (n) in Section 66D of the Finance Act, 1994, shall include any facility by which an amount of money is lent or allowed to be used or retained on payment of what is commonly called the time value of money which could be in the form of an interest or a discount. The relevant portion of the said Education Guide is reproduced herein below:

"4.14.2 What are the 'services by way of extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount'?"

The negative list entry covers any such service wherein moneys due are allowed to be used or retained on payment of interest or on a discount. The words used are 'deposits, loans or advances' and have to be taken in the generic sense. They would cover any facility by which an amount of money is lent or allowed to be used or retained on payment of what is commonly called the time value of money which could be in the form of an interest or a discount. This entry would not cover investments by way of equity or any other manner where the investor is entitled to a share of profit. Illustrations of such services are -

-
- Providing a loan or overdraft facility or a credit limit facility in consideration for payment of interest.
- Mortgages or loans with a collateral security to the extent that the consideration for advancing such loans or advances are represented by way of interest.
-

..... Emphasis Supplied

- A.15. The above said negative list clause (n) of Section 66D of the Finance Act, 1994, is *pari materia* to Serial No. 27 of the Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017, read with Maharashtra State Notification No. 12/2017-State Tax (Rate) dated 29.06.2017. Therefore, the Explanation given in CBEC Education Guide in respect of the said negative clause shall also be equally applicable to the present GST Exemption Notifications. Hence, the Penal Interest charged by the Applicant, which represents the consideration for time value of money (as explained above) would fall under the ambit of the GST Exemption Notifications, and accordingly, shall be exempt from GST.

A.16 In view of the above, it is submitted that the Penal Interest is nothing but interest on loans. Hence, the same shall be exempted from payment of GST under the Exemption Notifications.

A.17 Further, even under UK VAT law, the charges levied for deferment of payment beyond the time of supply have been treated as consideration for an exempt supply of credit. In this regard, reference is made to the UK VAT Notice 701/49: Finance, the relevant portion of which is extracted herein below:

***4.5 Deferred payments**

You may allow customers to defer payment but make an extra charge for allowing them to do so. If the charge relates to periods before and up to the time of the supply (see VAT Notice 700: the VAT Guide) it is not a charge for credit, but is further consideration for the supply of the goods or services. Alternatively, where you agree to defer payment beyond the time of supply and make an additional charge for doing so, such a charge will be consideration for an exempt supply of credit.

..... Emphasis Supplied

A.18 In view of the above, it is submitted that even internationally, the charges for deferment of payment are treated as consideration for exempt supply of credit, and therefore, the penal interest charged in the present case for deferment of the loan instalment should be treated as a consideration for exempt supply of loan, and hence, shall not be leviable to GST.

B. **In any case, penal interest is liable to be included in the value of main supply under Section 15(2)(d) of the CGST Act, and therefore, any treatment given to the main supply shall be given to the penal interest, and hence, shall be exempt from GST.**

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

"15. Value of taxable supply.

(2) The value of supply shall include

(d) interest or late fee or penal v for delayed payment of any consideration for any supply;"

..... Emphasis Supplied

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

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

B.4 In view of Section 15(2)(d) of the Act, any treatment given to the main consideration of supply shall also be equally applicable to the amount of interest or late fee or penalty charged/levied or collected for delayed payment of any consideration for a supply. Hence, by applying the said provision, the penal interest so collected by the Applicant in the present case, would be having the same tax treatment as that of the main consideration, i.e. interest, and therefore, it would also be exempt from GST under the Exemption Notifications.

C. **In any case, the penal interest charged by the Applicant is in the nature of penalty or liquidated damages for breach of contract, which does not amount to consideration for any contract, and therefore, there cannot be any supply of service.**

C.1 In any case, if the penal interest is not treated as interest on loan, then, the same shall be treated either as penalty or as liquidated damages for the default committed by the customers.

C.2 It is submitted that upon breach of contract, the aggrieved party is entitled to claim compensation for breach of contract. Such compensation is a legal and statutory right provided under Section 73 and 74 of the Indian Contract Act, 1872, and even without any specific clause in the contract for the damages or compensation payable upon the breach of contract, the party suffering such breach has the statutory right to claim damages or compensation from the party who has broken the contract.

C.3 The provisions of Section 73 and 74 are extracted herein below for reference:

***73. Compensation for loss or damage caused by breach of contract. -**

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

74. Compensation for breach of contract where penalty stipulated for. -

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

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

... Emphasis Supplied

- C.4 Both, Section 73 and 74, provide for reasonable compensation, but Section 74 contemplates that the maximum reasonable compensation may be the amount which may be named in the contract, but not more, even though, according to Section 73, the amount of compensation may exceed the sum named. In other words, Section 74 is narrower in scope and limits the compensation to the extent provided for, or stipulated in the contract.
- C.5 It is submitted that the damages in Section 74 may either be in the nature of liquidated damages or penalty. If the sum stipulated in the contract is a genuine pre-estimate of damages likely to flow from the breach, it is called liquidated damages. If it is not a genuine pre-estimate of the loss, but an amount intended to secure performance of the contract, it may be penalty. The question whether a particular stipulation in a contract, is in the nature of penalty has to be determined by the court against the background of various relevant factors, such as the character of the transaction and its special nature.
- C.6 It is relevant to note that the Explanation to Section 74 (supra), clearly states that a stipulation for increased interest from the date of default may be a stipulation by way of penalty.
- C.7 In the present case, the Applicant lends money to the customers with one of the conditions in the loan agreement that the customers shall make timely repayment of loan installments on the due dates as per the repayment schedule, and in case of any default, the Applicant shall be entitled to charge penal/default interest for the period of default at the specified rate (Refer Pg. No. 23, 26, 36 of the submissions made on 09.05.2018). Therefore, upon default in payment of the installments, the Applicant shall be entitled to receive damages stipulated in the contract in accordance with Section 74 of the Indian Contract Act, 1872.
- C.8 The Explanation to Section 74 (supra) directly covers the case of penal interest, wherein, higher rate of interest is charged from the customers from the date of default, so as to deter the customers from making such default in future. Therefore, looking from this angle, the penal interest charged by the Applicant may be treated as penalty for the breach of the contract. In any case, if it is held to be not penalty, then, the same shall be treated as liquidated damages.
- C.9 Therefore, in view of the above discussions, it is submitted that the penal interest charged in the present case shall be treated either as penalty or liquidated damages.
- C.10 It is submitted that payment of penalty or liquidated damages is not a consideration for any service, and therefore, the penal interest charged by the Applicant being in the nature of penalty or liquidated damages, cannot be treated as a consideration for supply of service, as they are merely damages for the breach of contract.
- C.11 It is a settled position in law that the stipulation for payment of damages upon breach of contract does not constitute a separate contract. It is only a part of the original contract. The payment of damages arises only on account of the primary contract, and it would be an incorrect interpretation to say that the payment is a consideration for any other contract. In the present case, there is only one contract between the Applicant and the borrower, which is the agreement for loan, for which consideration is payable by the borrower in the form of interest. The penal interest is payable by the borrower, only upon the breach of such contract, and therefore, such payment does not constitute a second contract. Therefore, the payment of penal interest by the borrower cannot be treated as a consideration either for the primary contract of loan, or for any other contract.
- C.12 Hence, in the absence of any consideration, the penal interest charged in the present case does not amount to a supply under Section 7 of the CGST Act, and therefore, the same shall not be leviable to GST.
- D. **Penal Interest charged by the Applicant for the breach of contract by the customer, is not covered under the ambit of Deemed Services under clause (e) of Entry 5 of Schedule II to the CGST Act.**
- D.1 It is further submitted that the penal interest shall not be covered by clause (e) of Entry 5 of Schedule I to the CGST Act, which reads as agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act. It is submitted that the expression "agreeing to the obligation" is a prefix to all the three entries, viz. 'to refrain from an act: to tolerate an act or a situation, and to do an act. Therefore, the correct interpretation of the law would be to read the above said clause as under:
- agreeing to the obligation to refrain from an act,
 - agreeing to the obligation to tolerate an act or a situation,
 - agreeing to the obligation to do an act
- D.2 Therefore, to attract the above said clause, there must be an agreement to the obligation in respect of any of the three entries. In absence of any such agreement, there cannot be a service. For a valid agreement, there has to be a consideration between the promisor and the promisee. However, as submitted above, the penal interest levied by the Applicant in the present case are merely damages for the breach of contract of loan, and are not consideration for any contract per se, and therefore, in the absence of any consideration, there can be no agreement to tolerate.
- D.3 Further, the above said clause uses the word 'obligation', therefore, it is important to understand the meaning of the said term to give correct interpretation to the entry. The said term has not been defined in the Finance Act, 1994, or the Rules made thereunder, therefore, reference is being made to the meaning given to it in other Statutes, and its dictionary meaning, as under:
- Section 2(a) of the Specific Relief Act, 1963: "Obligation" includes every duty enforceable by law.
 - Commentary on Section 2(a) of the Specific Relief Act, 1963, by Pollock & Mulla, at Pg. No. 1837 of Volume II, 14th Edition, reads as under: "Clause (a): Obligation

An obligation is a bond or tie, which constrains a person to do or suffer something; it implies a right in another person to which it is correlated, and it restricts the freedom of the obligee with reference to definite acts and forbearances; but in order to be enforceable, it must be an obligation recognised by law; and not merely a moral, social or religious one. An obligation may not be a legal one, where it cannot be reduced to a money value; **legal obligation includes every duty enforceable by law so that when a legal duty is imposed on the person in respect to another, the other is invested with a corresponding legal right.** This definition is used in its wider juristic sense as covering duties arising ex contractu or ex delicto, and may cover any other enforceable duty under any statute.

- Black's Law Dictionary:

- ****Obligation, (n.)**

1. A legal or moral duty to do or not do something. The word has many wide and varied meanings. It may refer to anything that a person is bound to do or forbear from doing, whether the duty is imposed by law, contract, promise, social relations, courtesy, kindness, or morality

2. A formal, binding agreement or acknowledgement of a liability to pay a certain amount or to do a certain thing for a particular person or set of persons; esp., a duty arising by contract.

3. Civil law. A legal relationship in which one person, the obligor, is bound to render a performance in favor of another, the obligee.'

- **Oxford Dictionary:**

obligation n.

1. an act or course of action to which a person is morally or legally bound. 1 the condition of being so bound. 2. a debt of gratitude for a service or favour.

..... Emphasis Supplied

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

D.5 However, in the present case, there is no obligation upon the Applicant to tolerate the act of non-payment or delayed payment by the borrower, in as much as, neither the Applicant has any duty or liability towards the borrower, for the borrower has any right on the Applicant. The payment of penal interest neither obligates the Applicant not to take any legal action against the borrower, nor the borrower gains any right to sue the Applicant for any legal action taken by the Applicant. On the contrary, the borrower is under the contractual obligation to make timely repayment of the loan to the Applicant, and upon the breach of such obligation, the Applicant is legally entitled to recover damages for such breach and also sue the borrower for such breach. It is further submitted that a sum which is payable in pursuance of a contractual obligation is different from a sum payable on a breach of contractual obligation. Therefore, the penal interest payable by the borrower on breach of its contractual obligation cannot be treated as a payment for any obligation on the Applicant towards the borrower.

D.6 D.7 In view of the above discussion, it is submitted that in the absence of an agreement by the Applicant to any obligation to tolerate the act of non-payment or delayed payment of loan installments by the borrowers, the mere recovery of penal interest for breach of the contract does not constitute a service by the Applicant to the borrower.

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

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

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

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

"9-10 Meaning of Supply

(1) A supply is any form of supply whatsoever.

(2) Without limiting subsection (1), supply includes any of these;

(g) an entry into, or release from, an obligation:

(i) to do anything; or

(ii) to refrain from an act; or

(iii) to tolerate an act or situation."

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

E.4 It is pertinent to bear in mind that the definition of supply" under the Australian GST legislation includes within its ambit an obligation to tolerate an act". Thus, when the aforesaid GSTR namely GSTR 2001/4 states that payment of liquidated damages is not toward's, any supply, it is reasonable to conclude that the GSTR

has also considered the clause "an obligation to tolerate an act". In other words, the GSTR impliedly concludes that the acceptance of liquidated damages does not amount to tolerating an act and hence would not fall within the ambit of "supply" for the purposes of GST.

- E.5 Further, in **New Zealand case S65 (1996) 17 NZTC 7408**, the Determination stated that an association, in accepting the payment of fine or penalty, does not enter into an obligation with the particular member to tolerate the misconduct but rather is fulfilling its obligation to all members to enforce the rules. The member does not gain rights additional to those which are already enjoyed by virtue of being a member. That is, upon payment of the fine or penalty, the member continues to enjoy the same rights and privileges and it follows that the association is required to continue to provide the benefits of membership. In this sense, it cannot be said that the association "makes" a supply where it already has a pre-existing obligation to continue to provide the benefits of membership.
- E.6 Further, in a decision of the Court of Appeal (U.K.) in case of **M/s. Vehicle Control Services Limited reported at (2013) EWCA Civ 186**, it has been observed that payment in the form of damages/penalty for parking in wrong places/wrong manner is not a consideration for service as the same arises out of breach of contract with the parking manager.
- E.7 In view of the above discussed rulings, it is submitted that the very purpose of liquidated damages or penalty is to retribute or make good the loss incurred by a person because of a default, non-compliance, etc., by the other person. Such liquidated damages or penalty may be in relation to some other supply of service or goods which would have a separate consideration and would be subject to certain terms and conditions. When such terms and conditions are not fulfilled, the defaulting party is obligated to make good the loss by paying liquidated damages. Such liquidated damages or penalty cannot itself become consideration for continuing with the main supply of service/goods by terming the same as towards tolerating the acts of the defaulting party.
- E.8 Thus, liquidated damages or penalty are merely for making good the loss suffered by a contracting party due to breach of terms of the contract by other contracting party. There is no additional benefit given under the main contract of supply of service, in return for the liquidated damages.
- E.9 Hence, in view of the above submissions, the penal interest levied by the Applicant cannot be treated as a supply of service, and therefore, is not liable to GST.
- F. It is submitted that the above submissions are in addition and without prejudice to the submissions made by the Applicant in its application dated 09.05.2018.

03. CONTENTION - AS PER THE CONCERNED OFFICE

Comments and submission regarding above referred application as follows.

BRIEF HISTROY:

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

The applicant inter alia enters into agreements with borrower/customers for providing loans to them. The loan agreements provide for repayment of the Loan as equated monthly instalments(*EMI) through ECS i. e. Electronic Clearing System/NACH i.e. National Automated Clearing House/Cheque/any other electronic or clearing mandate.

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

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

3. Scope of Supply :

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

As per Sec 7(1) (d) the activities to be treated as a supply of good or supply of services as referred in the schedule 2. As per schedule 2 para 5 clause (e) "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act"

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

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

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

3) Value of Supply:

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

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

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

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

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

04. HEARING

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

The final hearing was held on 18.07.2018, Sh. Sandeep Sachdeva, Advocate along with Sh. Arpit Chaturvedi, Advocate and Sh. Ganesh Mandhane National Head Taxation appeared and reiterated their submissions and contentions as per their submissions in case of GST ARA no.21 in their own case. Jurisdictional Officer Sh. Vinit Thite, State Tax Officer (VAT-C-707) Pune appeared and stated that they have already made written submissions earlier.

05. OBSERVATIONS

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

The Applicant, a non-banking financial company are providing various types of loan such as auto loans, loan against the property, personal loans, consumer durable goods loans, etc, to their customers and charge interest on such loans disbursed, for which they enter into agreements with borrower/customers. The agreements provide for repayment of the loan in the form of Equated Monthly Installments (EMI) vide cheque/Electronic Clearing System (ECS), etc. The installment of the loan is computed taking into consideration the amount of loan, duration of the loan and the amount of EMI that would be payable. The EMI paid by the customers is a fixed amount payable at a specified date, which includes both interest and the principal amount. In cases of delay in repayment of such EMI by the customers, the Applicant collects penal/default interest (hereinafter referred to as "penal interest"), in terms of the agreements executed by the customers. The same is calculated at a percentage not exceeding a fixed percentage, on the overdue loan amounts of the customer. The percentage of penal interest varies from customer to customer.

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

"1. DEFINITIONS AND ABBREVIATIONS,

r. "Penal Charges" shall mean and include overdue charges on non payment of installment on the due date.

.....

II. TERMS OF THE LOAN:

3. The Borrower agrees and confirms that:

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

- (a) for continuing non payment of amount due, a penalty not exceeding 3% per month on amount due calculated on pro-rata basis from due date till actually paid as per clause B of the schedule.

A perusal of the above extract reproduced by the applicant from a sample auto loan agreement (submitted by them in support of their argument that Penal Charges, collected by them is in the nature of additional interest) reveals that while drafting the agreement they themselves have defined 'Penal Charges' as 'overdue charges' for non-payment of installment on due dates. The definition nowhere mentions that the said charges are additional interest costs to be incurred by their customers. Further as per their extract the applicant 'is entitled to levy penalty for continuing non-payment of amount due, a penalty not exceeding 3% per month on amount due calculated on pro-rata basis from due date till actually paid as per clause B of the schedule'. It is very clear by a reading of this clause that the applicant themselves are treating the Penal Charges collected by them as "Penalty: It is also seen that such penal charges/penalty collected by them would be "not exceeding 3% per month on amount due calculated on pro-rata basis from due date till actually paid'. It would be pertinent to mention here that interest charges in general course of business are fixed at a certain rate and not at a rate 'not exceeding a certain percentage'. Thus it is very obvious that the amounts collected by the applicant from their customers are nothing but amounts towards Penalty/Penal Charges and can in no way be construed as additional interest. Such penalty/penal charges are collected by them from their customers for the reason that the said customers have delayed the payment of EMI and the applicant has tolerated the said act of their customers of delaying payment of such EMI.

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

- a. Compensation in the form of penal charges for delayed payment of EMIs by their customers.

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

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

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

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

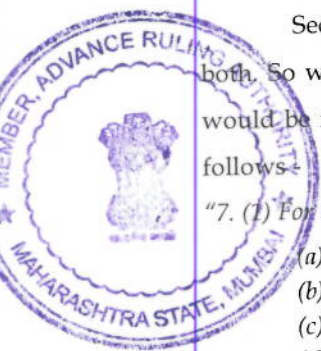
- (a) activities or transactions specified in Schedule III; or
 - (b) such activities or transactions undertaken by the Central Government.....,
- shall be treated neither as a supply of goods nor a supply of services.

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

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

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

1. Permanent transfer or disposal of business assets where input tax credit has been availed on such assets.
2. Supply of goods or services or both between related persons or between distinct persons as specified in sec 25.....
3. Supply of goods -



- (a) by a principal to his agent where the agent undertakes to supply such goods on behalf of the principal; or
 - (b) by an agent to his principal where the agent undertakes to receive such goods on behalf of the principal.
4. Import of services by a taxable person from a related person or from any of his other establishments outside India, in the course or furtherance of business.

SCH. II [See Sec.7] ACTIVITIES TO BE TREATED AS SUPPLY OF GOODS OR SUPPLY OF SERVICES

1. Transfer

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

2.

3.

4.

5. Supply of services

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

- (a)
 - (b)
 - (c)
 - (d)
 - (e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;
- and
- (f)
6.
7.

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

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

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

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

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

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

In the case before us we find that :-

- The applicant has given loans to their customers.

- The said loans were repayable by way of payment of EMI, which includes principal amount and interest.
- The EMIs are to be paid within due dates.
- Failure to repay EMIs by their customers result in penalty/penal charges being levied by the applicant on the amount of EMI default. They are contending that the said charges, which is a percentage of the EMI amount, are in the nature of interest. Thus what they are effectively submitting is that they are charging penal interest on the original interest amount also.
- In the process the applicant has agreed to do an act (tolerating the delayed payment of EMIs of their customers) in lieu of such penal charges/penalty payment being made to them as per the agreements.

Thus, the applicant has agreed to do an act (the act of tolerating, of delayed payment of EMIs by their customers) and such act, by the applicant, squarely falls under clause 5(e) of the Schedule II mentioned above and therefore the amounts received by the applicant for having agreed to do such an act, would attract tax liability under GST laws.

The applicant has reproduced Sr.No. 27 of Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017, and has submitted that the said Serial No. 27, grants exemption to the services by way of extending loans, in so far as the consideration is represented by way of interest.

Sl.	Chapter, Section, Heading, Group or Service Code (Tariff)	Description of Services	Rate (per cent.)	Condition
(1)	(2)	(3)		
27	Heading 9971	Services by way of (a) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services):	Nil	Nil

It is very clearly seen from a reading of the said Sr. No. 27 that Services by way of (a) extending deposits, loans or advances is exempted in so far as the consideration is represented by way of interest or discount. In this particular matter the amount of default charges are received by the applicant only because their customer/s have defaulted in making the due EMIs. This amount is over and above the interest amount received by them on account of extending deposits, loans, etc.

The applicant has further in A5 of their submissions stated that "interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred.....and therefore the word interest includes interest payable in any manner in respect of any moneys borrowed or debt incurred. They have further submitted that the Penal Charges collected by them is an additional interest for the delay in payment of loan installment beyond the due date and that while computing the EMI/installment amount, the interest is factored in the EMI on the assumption that all the installments would be paid on time. Here we would like to mention that the interest is calculated on the entire tenure of the loan given and then on that basis and the amount of loan EMIs are collected from their customers. The interest amounts are not calculated on a monthly basis and therefore it cannot be said that the default charges is for the period of

delay not included in the EMI/installment amount. They have also submitted that the amount of overdue loan installment is virtually a new loan transaction, the consideration for which is the penal interest charged on such overdue loan installment. This assumption by the applicant that the EMI is nothing but a new loan amount advanced to the applicant is not only fallacious but also devoid of merit because from the agreements it is seen that the rate of interest on the loan advanced and the rate at which penal charges are collected on the so called new loan amount (i.e. the defaulted EMI) are also different. Further from their submissions it would seem that the penal charges, which are termed by them as additional interest, such so called additional interest is also levied on interest component of the EMI. Another important point is that the applicant themselves have submitted that the percentage of penal interest varies from customer to customer, and generally ranges between 2% to 4% per month depending on the product. This clearly shows that such amount collected by them in case of default by their customers does not have a fixed rate as in the case of interest on advances of loans, etc. In their copy of agreement at page 19 of their submissions, with **Punya Nath Mishra**, in respect of an auto loan it is seen that the rate of interest on the loan is a flat rate i.e. 7.99%. At point no. q of the said Auto-Loan Agreement it is mentioned that **"Penal Charges shall mean and include overdue charges on non payment of installment on the due date."**

We observe herein that the receipt of penal charges on delayed payment of EMIs would be receipt of amounts for tolerating the act of their customers for having delayed/defaulted on their EMI payments within due dates. In view thereof, the same would definitely be a 'supply' under the GST Act and therefore, there arises an occasion to levy tax under the GST Act on the impugned transactions.

Thus we find clearly from the above discussions and as per the terms and conditions of the agreement submitted by them that there is clearly an agreement that the applicant, in the case of default of payment of EMI by their customer, the applicant would tolerate such act of default or a situation and the defaulting party i.e. their customer was required to compensate the applicant by way of payment of extra amounts in addition to principal and interest as per the terms and conditions of the Agreement. It is also very clear as to the amount or quantum which is consideration in the form of penal charges being additional interest to be received by the applicant if these are suitable compensation only for tolerating the act of default or situation of default by their customers and are not additional interest as claimed by the applicant. We see from the definition of 'Additional Interest' is given in the referred agreement which clearly indicate that the additional interest is not in the nature of interest but is penal charges.

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

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

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

In the present case as per details presented before us, we clearly find that there is a clear understanding or agreement between the parties to foresee and tolerate an act or a situation of default on the part of loanees for a monetary consideration which is actually a consideration received by the applicant, though in the agreement they may be giving this consideration, other names such as 'penal interest', penal charges, penalty, etc. as thought proper by them, but these different nomenclatures in their Agreement

would in no way change the actual nature of monetary "consideration" which would clearly be taxable for the supply of services as per Sr.No. 5(e) of Schedule II of the CGST Act, 2018.

We find that the exemption for financial transactions under GST laws is only in respect of the interest/discount earned or paid for loans, deposits or advances. If the transaction, as in the subject case deviates from the above the same fails the test of being a "loan", "deposit" or "advance", or the consideration is not an interest or discount, the exemption is not admissible. In the subject case the amount of penal charges cannot be said to form a part of interest on "loan", "deposit" or "advance". It is recovered/imposed only because the loanee has delayed the payment of EMI (which consists of the principal amount and interest amount). This recovery of penal charges is made in view of toleration of the act of the loanee by the applicant and therefore construes as 'supply' as per as per Sr. No. 5(e) of Schedule II of the CGST Act and is therefore taxable under the GST Act.

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

ORDER

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

NO.GST-ARA- 22/2018-19/B-

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Mumbai, dt.

06.08.2018

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

Question 1:- Whether the Penal Interest is to be treated as interest for the purpose of exemption under Sr. No. 27 of Notification No. 12/2017 Central Tax (Rate) dated 28.06.2017, Sr. No. 27 of Maharashtra State Notification No. 12/2017-State Tax (Rate) dated 29.06.2017, and Sr. No. 28 of Notification No. 9/2017 Integrated Tax (Rate) dated 28.06.2017?

Answer :- Answered in the negative.

Question 2:- If the answer to the above is negative, whether the activity of collecting penal interest by the Applicant would amount to a taxable supply under the GST regime?

Answer :- Answered in the affirmative. The said activity squarely falls under clause 5(e) of the Schedule II of the GST Act, 2017. Therefore such amounts received, would attract tax liability under GST laws.



—sd—
B. V. BORHADE
(MEMBER)

—sd—
PANKAJ KUMAR
(MEMBER)

CERTIFIED TRUE COPY

Copy to:-

1. The applicant
2. The concerned Central / State officer
3. The Commissioner of State Tax, Maharashtra State, Mumbai
4. The Chief Commissioner of Central Tax, Churchgate, Mumbai
5. Joint commissioner of State tax , Mahavikas for Website.

MEMBER
ADVANCE RULING AUTHORITY
MAHARASHTRA STATE, MUMBAI

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