



## Dimensions – 42<sup>nd</sup> Edition

### 1. M/s Rashtriya Ispat Nigam Ltd. - Andhra Pradesh<sup>1</sup>

#### Issues for Consideration

- Whether the liquidated damages (LD) and other penalties like milestone penalties levied for delay in supply of goods or services by the vendor / supplier are liable to GST?
- If yes, then what would be the time of supply?
- Whether the LD and other penalties paid by the vendors are covered under entry no. 5(2)(e) of Schedule II of the CGST Act, vide HSN code 9997, taxable at the rate of 18%, or is covered elsewhere?
- Where a delay in supply has occurred before the implementation of GST and after GST as well, whether GST will be applicable on the damages with respect to the entire delay or only on the delay that occurred after GST implementation?

#### Discussion & Ruling

##### Discussion:

- The Applicant is engaged in manufacturing and selling steel products.
- The Applicant procures raw materials for manufacturing the product and spare parts and machinery parts for maintenance of plants. The agreements entered into with the contractors / vendors contain a clause to deduct LD in case of default by the contractor / vendors to complete the work / supply in time.
- The LD is deducted in following cases:
  - **Operation and maintenance activities**  
In case of delay in providing materials or services required for operational activities, LD is deducted from the amount payable to the vendor and are treated as other miscellaneous income;
  - **Construction of new plant or renovation of old plant**

<sup>1</sup> Order no. AAR 01/AP/GST/2019 dated January 11, 2019



- If the construction of the plant is not completed within the agreed timelines and the vendor / contractor is responsible for delay, then LD would be calculated and charged to the vendor / contractor;
  - Similarly, in the case of turnkey contracts, if the work is not completed within the timelines fixed for the milestones, then the milestone penalties would be charged before completing the delay analysis;
  - In the interim the amounts equal to the LD and milestone penalties are withheld from the bills;
  - The LD / milestone penalties are treated as other miscellaneous income after completion of delay analysis.
- The Applicant approached the Authority, since this issue was of a recurring nature and contended that no GST is payable on such LD / milestone penalties on the following basis:
    - LD is charged to indemnify the loss suffered by the Applicant. There is no agreement to supply the 'service of tolerance of delay'. It is charged to ensure that the work is completed within time;
    - There is only one contract for execution of supplies. The LD / penalties arise out of the same contract. GST is already charged on the executed portion of the contract and levying further GST on the LD / penalties would amount to double taxation;
    - The expression to 'tolerate an act' under entry 5(2)(e) of Schedule II of the CGST Act, would cover only those instances where the consideration is charged in order to allow another person to undertake any particular activity. It cannot include situations where the penalty is charged for breach of terms and conditions of the contract;
    - There would be a contractual relationship under the entry 5(2)(e) (*supra*), if the service receiver requests the service provider to tolerate an act, and the service provider obliges to tolerate, subject to a consideration being paid.
    - Reliance was placed upon section 73 and 74 of Indian Contracts Act 1872, to state that LD is paid to compensate the person who has suffered any loss in terms of the contract.
  - The Authority observed as follows:
    - As per the agreement, the liability of payment of LD arises when it is established that the delay in execution of the contract is on account of the contractor. Thus, the act of delayed supply has happened and is tolerated by an additional levy in the nature of LD;
    - By deducting the LD charges, the contractor is not relieved from his obligations under the contract to complete the work. This is just to ensure that the obligations under the contract are completed;
    - The right to levy LD is created because there is a delay, and the same would be tolerated in the form of price or damages;



- Such LD / penalty levied would be the income of the Applicant and regarded as supply of a 'service' in terms of entry 5(2)(e) (*supra*);
- Such levies should be covered under HSN 9987 and taxable at the rate of 18%;
- In respect of time of supply, the liability for levy of damages or penalties does not arise when the delay has occurred, but when the delay is established on the part of contractor. This would define time of supply which needs to be determined in terms of section 13(1) of the CGST Act;
- LD received / collected during pre-GST regime would be dealt with in accordance with the then existent provisions under applicable laws.

**Ruling:**

- The Applicant is liable to pay GST on the LD / penalties collected;
- The supply of service in form of tolerating an act would get covered under entry 5(2)(e) of Schedule II of CGST Act vide HSN 9987 and taxable at the rate of 18%;
- Time of supply would be defined by the time when liability to levy LD and penalty is established on the part of the contractor;
- The Applicant has not provided the precise facts related to the agreement before the Authority, hence for levy of GST on damages with respect to delay in pre-GST regime, section 14 of the CGST Act, 2017 would be referred.

**Dhruva  
Comments /  
Observations**

- The ruling levies GST on LD by classifying the same under Schedule II of the CGST Act, without discussing the applicability of Section 7(1A) of CGST Act.
- Though the levy of tax on LD has been a subject matter of dispute during the Service tax regime and GST, it seems that the Appellate Authorities<sup>2</sup> and lower Authorities<sup>3</sup> for Advance Rulings under GST have been consistently upholding the levy of GST on such charges.
- It would be critical to examine contracts to assess whether receipts arise from any supply or is attributable to contractual breach.

<sup>2</sup> Maharashtra State Power Generation Company Ltd. [2018 (17) GSTL 451 (App. AAR GST)]

<sup>3</sup> North American Coal Corporation India Pvt Ltd. [2018 (18) GSTL 525 (AAR – GST)]



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