CUSTOMS, EXCISE AND SERVICE TAX APPELLAT TRIBUNAL
REGIONAL BENCH AT HYDERABAD

Division Bench – Court No. - I

Service Tax Appeal No.30227 of 2016

(Arising out of Order-in-OriginalNo.VIZ-EXCUS-003-COM-010-2015-16 dated 31.12.2015 passed by Commissioner of Central Excise & Service Tax, Nellore Commissionerate.)

M/s.Krishnapatnam Port Company Limited
(P.O.Bag No.1, MutthukurMandal, District Nellore, Andhra Pradesh-524344.)

...Appellant

VERSUS

Commissioner of Central Excise & Service Tax, Guntur

.....Respondent
(Central Revenue Building, Kannavarithota, Guntur-522004.)

APPEARANCE

ShriC. Manickam, Advocate for the Appellant (s)

ShriS. Hanuma Prasad, Authorized Representative for the Respondent (s)

CORAM:HON'BLE SHRI P.K.CHOUDHARY, MEMBER(JUDICIAL)
HON'BLE SHRI P.V.SUBBA RAO, MEMBER(TECHNICAL)

FINAL ORDER NO: A/30056/2022

DATE OF HEARING : 10 March 2022
DATE OF DECISION : 25 April 2022 .

P.K.CHOUDHARY :

The Appellant is engaged in rendering 'Port Services' to importers and exporters and vide Agreement dated 12.07.2011, entered into a contract with M/s. Simhapuri Energy (P) Ltd. (hereinafter referred to as the 'service recipient') wherein the service recipient agreed to import a specified quantity of coal in a specified period of time and the Appellant agreed to render 'port services' for the same for a consideration. The said Agreement also provides for payment of penalty/liquidated

damages/'compensation charges' of Rs.100/MT by the services recipient in the event of failure to achieve the 'Minimum Guaranteed Tonnage' [hereinafter referred to as MGT]. The relevant extract is reproduced below for ready reference:

> *"6.5 SEPL/PTC commits minimum volumes as under from the date of NTP and KPCL agrees for the facilities accordingly:-*
>
> *1) …….*
>
> *2) …….*
>
> *3) …….*
>
> ***SEPL/PTC shall be liable to pay a compensation charge of Rs.100/- (Rupees One Hundred only) per MT for the difference (shortfall) of quantity in the event not achiving minimum guaranteed tonnage for the respective period."***

2. The Service Tax Department, Guntur issued a Demand Notice to Appellant proposing to recover Service Tax amounting to Rs.1,13,85,022/- on the ground that the receipt of 'compensation charges' amounts to consideration for providing taxable service. The Commissioner of Central Tax, Guntur vide Order dated 31.12.2015 has confirmed the demand for normal period as well as for extended period of limitation along with equivalent penalty holding that the said activity amounts to a 'declared service' under Section 66E(e) of the Finance Act, 1994. Hence the present Appeal before the Tribunal.

3. The core issue thus relates to whether the liquidated damages/'compensation charges' received by the Appellant towards the breach and non-compliance of 'MGT' as per Agreement dated 12.07.2011 can be viewed as 'consideration' for "declared service" as contemplated under Section 66E(e) of Finance Act, 1994 for the purpose of charging Service Tax.

4. Heard both sides through video conferencing and perused the Appeal records.

5. We find that penalty clause is provided in the impugned Agreement dated 12.07.2011 to safeguard the commercial interest of the Appellant – (1) to compensate the Appellant for financial damage/injury in case of failure to achieve the MGT and also (2) to

discourage the service recipient from repeatedly breaching the terms and conditions of the Agreement dated 12.07.2011 and the penal clause is invoked only in cases where the service recipient does not adhere to the contractual condition of 'MGT' as per Agreement dated 12.07.2011.

6. We find that as per Finance Act, 1994, the basic element to charge Service Tax is the element of service i.e. there should be an activity in the form of 'service' or 'declared service'. However, in the instant case, the said amount has not been collected towards any activity liable for Service Tax but as compensation/penalty for breach of terms and conditions of the contract [Agreement dated 12.07.2011] i.e. non-compliance of 'MGT'. Thus, such 'compensation charges' are not covered within the definition of taxable service under the Finance Act, 1994 and hence not liable for Service Tax.

7. As per Section 66E(e) of Finance Act, 1994,'declared service' means "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act". Thus, for invocation of the said clause, there has to be an action, passive action or reaction which is declared to be a service namely;

- To refrain from an act or
- To tolerate an act or a situation or
- To do an act

In other words, there has to be first a concurrence to assume an obligation to refrain from an act or tolerate an act etc. which is clearly absent in the present case.

8. We find that, in the instant case, the parties entered into the said Agreement dated 12.07.2011 for import of a specified quantity of coal and for availing various port services for the same and not for flouting the terms of the agreement so that the penal clauses were the reason for the execution of the Agreement dated 12.07.2011 for an agreed consideration. It is only in situations where the condition of 'MGT' is not satisfied by the service recipient, the Appellant's claim for penalty/compensation/liquidated damages as contemplated in Para

6.5.3 of the Agreement dated 12.07.2011 arises so as to make good the financial damages/injuries arising from such non-fulfillment of 'MGT' and does not emanate from any obligation on the part of the Appellant to 'tolerate an act or a situation' of the defaulting party and cannot be considered to be a payment for any service. Reliance in this regard is placed on the recent decision of the Tribunal in the case of M/s.South Eastern Coalfields Ltd. v. CCE & ST, Raipur [2020 (12) TMI 912].

9. We find that the term service is defined to mean any activity carried out by a person for another for consideration. The recovery of liquidated damages/penalty from the other party in the instant case cannot be said to be towards any service per se, as the Appellant did not carry on any activity to receive the 'compensation charges'. Hence, scope of levy of Service Tax cannot be extended to apply to situations where the actual activity was non-existent.

10. The activities that are contemplated under Section 66E(e)*ibid* are activities where the agreement specifically refers to any of the activities mentioned in Para 6 above and there is a flow of consideration for such activity. Thus, a service conceived in an agreement where one person, for a consideration, agrees to an obligation to refrain from or tolerate or do an act, would be a 'declared service' under Section 66E(e) *ibid.* Any amount charged which has no nexus with the taxable service and is not a consideration for the service provided does not become part of the value which is taxable. In other words, the amount charged has to be necessarily a consideration for the taxable service provided under the Finance Act. In the instant case, the compensation received for making good the financial damages/injury cannot be said to be 'consideration' at all and has no nexus with any taxable service. Reliance in this regard is placed on the decision in the case of M/s.K.N.Food Industries Pvt.Ltd. v. Commissioner of CGST & Central Excise, Kanpur [2019-VII-731-CESTAT-ALH-ST].

11. We find that as held by the Tribunal in M/s.SouthEastern Coalfields Ltd. v. CCE & ST, Raipur (supra), there is marked distinction between "conditions to a contract" and "considerations for the

contract". A service recipient may be required to fulfill certain conditions contained in the contract but that would not necessarily mean that this value would form part of the value of taxable services that are provided. Hence, payment of the impugned 'compensation charges' in the present case merely amounts to fulfillment of the condition envisaged in Para No.6.5.3 of the Agreement dated 12.07.2011 and not consideration for the said contract [Agreement dated 12.07.2011].

12. Further, the issue of leviability of Service tax on penalty, liquidated damages, compensation, forfeiture amounts, cancellation charges etc. stands settled by various pronouncements wherein it has consistently been held that the said amounts recovered as charges for breach or non-compliance of contractual terms and conditions cannot be construed as 'consideration' for 'refraining or tolerating an act' and were thus not leviable on Service Tax in terms of Section 66E(e) of the Finance Act, 1994. Reliance in this regard is placed on the following decisions:

(i) M/s. K.N.Food Industries Pvt.Ltd. v. Commissioner of CGST & Central Excise, Kanpur [2019-VIL-731-CESTAT-ALH-ST] wherein it was held that if a contract provides for an eventuality which is uncertain and also remedy if that eventuality occurs, such charges made towards making good the damages, losses or injuries arising from unintended events cannot be considered to be the payments for any services under Section 66E(e) of Finance Act, 1994.

(ii) M/s. Monnet Ispat& Energy Ltd. v. CCE & ST, Raipur [2018 (9) TMI 1514] – while deciding whether Service Tax liability arises on the UI Charges received by the Company in terms of Section 66E(e) of the Finance Act, 1994, the Court held that UI Charges have been received by the Appellant only in those cases where the buyer has drawn more electricity than what was scheduled for him and does not amount to consideration for declared service.

(iii) M/s. Lemon Tree Hotels v. Commissioner, GST, Central Excise & Customs [2019 (7) TMI 676] wherein it was held that 'cancellation

charges' collected in lieu of cancellation of booking of hotel room does not attract Service Tax in terms of Section 66E(e) of the Finance Act.

(iv) In M/s. South Eastern Coalfields Ltd. v. CCE & ST, Raipur [supra]- The Tribunal held that the view taken by the Principal Commissioner that penalty amount, forfeiture of earnest money deposit and liquidated damages have been received by the Appellant towards "consideration" for "tolerating an act" leviable to Service Tax under Section 66E(e) of the Finance Act cannot be sustained and also relied on the following decisions of the Hon'ble Supreme Court:

a. *Commixxioner of Service Tax vs. M/s. Bhayana Builders [2018 (2) TMI 1325]* wherein the Apex Court observed that any amount charged which has no nexus with the taxable service and is not a consideration for the service provided does not become part of the value which is taxable under the Finance Act.
b. *Union of India vs. International Consultants and Technocrats [2018 (10) GSTL 401 (SC)]* – since Service Tax is with reference to the value of service, as a necessary corollary, it is the value of the services which are actually rendered, the value whereof is to be ascertained for the purpose of calculating the Service Tax payable thereupon.

(v) M/s.M.P. Poorva Kshetra Vidyut Vitran Co. Ltd. v. Principal Commissioner CGST and CE, Bhopal [2021 (2) TMI 821], wherein the ratio of the decision in the case of M/s.South Eastern Coalfields (supra) was followed and the order confirming the demand of Service Tax on the amount collected towards liquidated damages and theft of electricity was set aside.

Hence, the present issue is no more *res integra* and has attained finality in view of the aforesaid judicial decisions.

In view of the above discussions, the impugned order cannot be sustained and is accordingly set aside. Thus, the Appeal, filed by the Appellant, is allowed with consequential relief, as per law.

(Order pronounced in the open court on 25.04.2022.)

(P.K.CHOUDHARY)
MEMBER (JUDICIAL)

(P.V.SUBBA RAO)
MEMBER (TECHNICAL)

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