

सत्यमेव जयते

AUTHORITY FOR ADVANCE RULING - ANDHRA PRADESH

Goods and Service Tax

D NO 5-56, Block-B, R.K. Spring Valley Apartments,
Edupugallu, Bandhar Road, Vijayawada-521151

Present:

Sri.D. Ramesh, Additional Commissioner of State Taxes.....

Member (State Tax)

Sri.S. Narasimha Reddy, Joint Commissioner of Central Tax.....

Member (Central tax)

AAR NO.01 /AP/GST/2019 dated: 11.01.2019

1.	Name and address of the applicant	RASHTRIYA ISPAT NIGAM LTD Visakhapatnam Steel Plant, Visakhapatnam, Andhra Pradesh.
2.	GSTIN	37AABCR0435L1ZD
3.	Date of filing of Form GST ARA-01	25.09.2018
4.	Date of Personal Hearing	10.12.2018
5.	Represented by	Srinivasa Rachamalla, Assistant General Manager
6.	Jurisdictional Authority –Centre	Assistant Commissioner Central GST Division, Central tax, Visakhapatnam South
7.	Clause(s) of section 97(2) of CGST/SGST Act, 2017 under which the question(s) raised	g) Whether any particular thing done by the applicant with respect to any goods or services or both amounts to or results in a supply of goods or services or both, within the meaning of that term.

Order:

(under sub-section (4) of Section 98 of Central Goods and Service Tax Act, 2017 and under sub-section (4) of Section 98 of Andhra Pradesh Goods and Services Tax Act, 2017)



1. The present application has been filed U/s 97 of the Central Goods & Services Tax Act, 2017 and AP Goods & Services Tax Act, 2017 (hereinafter referred to as CGST Act and APGST Act respectively) by RASHTRIYA ISPAT NIGAM LTD, registered under the Goods & Services Tax.

2. The provisions of the CGST Act and APGST Act are identical, except for certain provisions. Therefore, unless a specific mention of the dissimilar provision is made, a reference to the CGST Act would also mean a reference to the same provision under the APGST Act.

3. Brief Facts of the case:

M/S RASHTRIYA ISPAT NIGAM LTD, hereinafter referred to as the applicant, is a Central Public Sector Undertaking under the Ministry of Steel with Navaratna Status. They have an integrated steel plant at Visakhapatnam, Andhra Pradesh, and are in the business of manufacture and selling of steel products. The steel plant consists of many sub plants, like Coke Oven battery, Raw material Handling Plant, Sinter Plant, Blast Furnace, Steel Melting Shops, Rolling Mills and other units and each sub plant itself is a big unit or plant and the final steel product undergoes all the process through various sub plants. Initially the plant was installed with 3 million tons capacity. The plant is further taken up for expansion to 7.3 million tons capacity. Apart from procuring raw materials like iron ore, coking coal, boiler coal, ferro alloys in huge quantities, it also procures spare parts and machinery parts in huge quantities for maintenance of its plant(s).

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



Type 1: Operation & maintenance activities:

In the normal course of business of steel manufacture and sale/ distribution of its products, RINL enters in to various contracts with vendors for providing materials and services for operational activities. In this case, if there is any delay on the part of the supplier/contractor to provide materials/ services, Liquidated damages (LD) are deducted from the amount payable to such vendor. The LD so deducted is treated as other miscellaneous income. (A copy of the contract for material supply containing the LD clause is submitted at Annexure-I as a sample copy)

Type 2: Construction of new plant in expansion project or renovation of old plant

In this type of contracts, normally the contract is awarded to vendors to build the sub plant or a part of it on Turnkey basis. Normally the contracts are awarded in two parts. One for designing, manufacture and supply of machinery and another for storage, erection & commissioning. As per the terms and conditions the period of completing the contract is fixed. When plant construction is completed, the actual time taken for completion of contract would be calculated. If there is any delay in completing the contract, the factual position would be ascertained, particularly to know the fact whether the contractor/vendor is responsible for the delay or not. If the delay is on account of the contractor, then Liquidated Damages would be calculated as per the contractual terms and same will be charged from the contractor.

Further, in the case of turnkey contracts the execution of work is monitored by dividing the stages of execution as reaching various milestones. If the execution of work is not as per the targets or milestones, achievements fixed, penalties also would be levied as milestone penalties before completing delay analysis. However, in the interim, the amounts equivalent to LD & milestone penalties are withheld from the bills.

In accounting, LD / milestone penalties imposed are treated as other miscellaneous income. This would be taking place after completion of delay analysis.

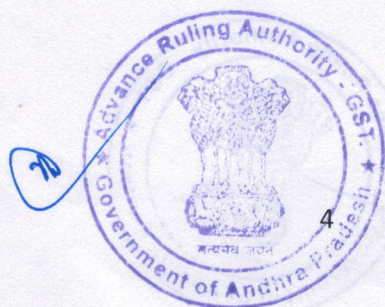


A copy of the turnkey contract for "Design, Engineering and Supply of all equipment including commission spares and Insurance Spares for Indoor LBDS, HVLC and Interplant Cabling" is submitted as Annexure-II as sample copy, for information.

Particulars	Supply	Erection
Contract Description	Supply-Indoor LBDS, HVLC & Interplant Cabling	Erection-Indoor LBDS, HVLC & Interplant Cabling
Contract Value (Org.)	56,25,88,468.20	1,04,63,131.00
Date of Fax Letter of Acceptance	23.01.2008	23.01.2008
Date of Agreement	18.09.2008	18.09.2008
Date of Commencement	23.01.2008	23.01.2008
Date of Completion (Original)	22.04.2009	22.06.2009
Date of Completion (Actual) - Pre GST	27.07.2015	17.07.2015
No. of Extensions	23 extensions	20 extensions
Date of completion of Delay Analysis - Pre GST	04.06.2016	04.06.2016
amount of LD (5% of Contract Value)	2,81,49,184.00	5,68,025.00
Dates of withholding of LD Pre GST	03.01.2015,	10.12.2016
	17.11.2015,	
	20.01.2016.	
Date on which LD was transferred to P&L - Post GST	31.03.2018	31.03.2018

The contracts are inclusive contracts i.e. inclusive of Excise Duty & CST/APVAT, LD is calculated on the total contract value.

The applicant had filed an application in form GST ARA-01, dt:25.09.2018, paying the prescribed amount of fee for seeking Advance Ruling on the following issues.



The applicant sought Advance Ruling on

- 1) Whether "Liquidated Damages" and other penalties like milestone penalties levied on suppliers/ contractors in the nature of making good the damages for any delays in supply of service or goods in the following cases are exigible to GST or not?
 - a) Supply and maintenance contracts
 - b) Project construction contracts
- 2) If GST is applicable, the following may kindly be clarified
 - a) Whether the GST on Liquidated Damages, and other penalties is covered under Schedule II entry No. 5(2)(e) vide HSN code 9997 – Other services, for which the rate at 18% is relevant or any other entry is applicable?
 - b) Liquidated damages are determined and imposed upon the contractor after in-depth study. In such case, what would be the time of supply? Will it be the period in which delay has occurred or it is the time when decision is taken or at the time when accounting entry for recovery is passed?
 - c) When some part of the delay in supply has occurred before the implementation of the GST and some part of delay in supply has occurred after GST came into force, whether GST will be applicable to the Liquidated damages imposed for entire period of delay or it would be applicable only to the period falling after introduction of GST?

4. Reason for filing the application before the Authority:

The applicant being a Public Sector Company and the issues raised in the application are of recurring nature, an authoritative ruling is required to avoid future complications and to have more clarity in implementing the GST Law.



5. **Applicants interpretation of law and facts:**

1) There is only one contract of supply:

There is only one contract for execution of the concerned supply of goods or services. The purpose of deducting the amount towards liquidated damages is to indemnify the loss to RINL due to non-receipt of goods or services as per the agreed terms and conditions by the vendors. There is no agreement between the applicant and the contractor/vendor wherein the company is intending to supply "service of tolerance of delay". The delay is neither desired by the applicant nor the vendor/contractor but is to impress upon the vendor/ contractor to adhere to timelines and to make good the loss caused to the applicant, because of delay-in supplies. It is never the intention of the applicant to get its project/ supplies delayed nor do the contractors / vendors want to make delay and thereby causing applicant to tolerate it. Rather, the applicant intends that the contractors/suppliers complete the job within the time if not earlier. In some of the contracts, it is offered bonus when the contractor completes the job before time in which event the contractor collects GST on the bonus value. In other words, the applicant pays GST whenever bonus amount is paid to contractor(s). It is never the intention of the applicant to enrich itself at the cost of the contractors/vendors by recovering LD.

As submitted, there is only one contract for execution of supplies. The issues like Liquidated damages, milestone penalties etc. arise out of the same contract. Since the executed portion of the contract value already suffers GST, levying of further GST on damages or compensation measures like LD and, milestone penalties etc imposes double taxation on the contract values. Imagining existence of one more contract for tolerating an act or a situation, which is not the intention of the parties, and levying GST on the basis of such imaginary contract treating the LD as a result of such contract, is not justified.



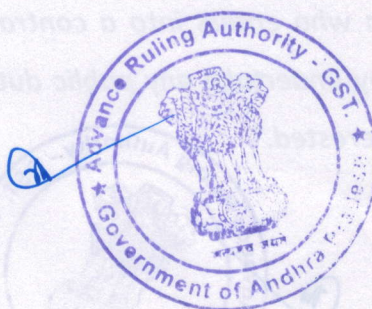
2) Entry 5(e) of Schedule II is not applicable for LD and milestone penalties:

As per entry 5(e) of Schedule II of the CGST Act, an activity of "agreeing to the obligation to refrain from an action, or to tolerate an act or a situation, or to do an act" shall be treated as supply of service. The expression to 'tolerate an act' 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 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/fine 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. The expression 'agreeing to tolerate an act' cannot be construed to include situations wherein penalty is charged by a party for breach of terms and conditions of the contract committed by other party.

Further, the word 'obligation' used in entry 5(3) indicates the need for the existence of the desire in the person for whom the activity is done. In other words, when the service receiver requests the service provider to tolerate an act/situation and the service provider obliges to tolerate, provided a consideration is paid, then such a contractual relationship will get covered by entry 5(e) of Schedule II.

3) Compensation for loss or damage caused by breach of contract is not a service:

Liquidated damages are recovered for compensating the loss suffered by the recipient. The section 73 and 74 of the Indian Contract Act, 1872 provides for recovery of liquidated damages in case of breach of contract. The provisions of section 73 and 74 of the Indian Contract Act, 1872 reads as follows.



"73. Compensation for loss or damage caused by breach of contract:

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

"74. Compensation for breach of contract where penalty stipulated for:

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

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

Exception: When any person enters into any bail-bond; recognizance or other instruments of the same nature, or, under the provisions of any law or under the orders of the Central Government or of any State Government, gives any bond for the performance of any public duty or act in which public are interested, he shall be liable, upon breach of the condition of any such instrument, to pay the whole sum mentioned therein.

Explanation: A person who enters into a contract with Government does not necessarily thereby undertake any public duty or promise to do an act in which public are interested."



It has been consistently held that liquidated damage is to compensate the person for loss suffered by him the amount of loss suffered by appellant due to delay as mentioned in the contract. The damages are not received by the person for the toleration of an act, but it is made to compensate the loss suffered by the appellant.

In view of the above submissions, Applicant prayed the Advance Ruling Authority to consider that the damages in the form of LD or penalties are not subject to GST.

6. RECORD OF PERSONAL HEARING:

Sri A. Sarweswara Row, Authorized Representative appeared for personal hearing on 10.12.2018 and reiterated the submission already made in the application. In addition to that, he submitted the relevant documents related to computation of LD charges at the time of hearing\

7. DISCUSSION AND FINDINGS

We have gone through the facts of the case. The questions posed are in respect of 'liquidated damages'. We find that the applicant contends that there is only one contract of supply, Entry 5(e) of Schedule II is not applicable for LD and milestone penalties, and Compensation for loss or damage caused by breach of contract is not a service.

In the normal course of business of steel manufacture and sale/ distribution of its products, RINL enters in to various contracts with vendors for **providing materials and services** for operational activities. In this case, if there is any delay on the part of the supplier/contractor to provide materials/ services, Liquidated damages (LD) are deducted from the amount payable to such vendor. The LD so deducted is treated as other miscellaneous income. In respect of contracts relating to Construction of new plant in expansion project or renovation of old plant, normally the contract is awarded to vendors to build the sub plant or a part of it on Turnkey basis. Normally the contracts are awarded in two parts. One for designing, manufacture and supply of machinery and another for



storage, erection & commissioning. As per the terms and conditions the period of completing the contract is fixed. When plant construction is completed, the actual time taken for completion of contract would be calculated. If there is any delay in completing the contract, the factual position would be ascertained, particularly to know the fact whether the contractor/vendor is responsible for the delay or not. If the delay is on account of the contractor, then Liquidated Damages would be calculated as per the contractual terms and same will be charged from the contractor.

Further, in the case of turnkey contracts the execution of work is monitored by dividing the stages of execution as reaching various milestones. If the execution of work is not as per the targets or milestones or achievements fixed, penalties also would be levied as milestone penalties before completing delay analysis. However, in the interim, the amounts equivalent to LD & milestone penalties is withheld from the bills.

In Accounting, LD / milestone penalties imposed are treated as other miscellaneous income. This would be taking place after completion of delay analysis. In the present case, Agreement provided that the liability of payment of these Liquidated Damages by the contractor will be established, once the delay in successful execution of work is established on the part of the contractor. Thus, the act of delayed supply has happened. The same was being tolerated by an additional levy in the nature of liquidated damages. The agreement had also provided that the payment by contractor or deduction by owner of any sums under the provision of this clause shall not relieve the contractor from his obligations to complete the works or from his other obligations under the contract. This provision just ensured that the obligations under the contract are fulfilled. The facts are much obvious that the empowerment to levy liquidated damages is for the reason that there had been a delay and the same would be tolerated, but for a price or damages. The income though presented in the form of a deduction from the payments to be made to the contractor was the income of the applicant and would be a supply of 'service' by the applicant in terms of clause (e) of Para 5 of Schedule II appended to the Central Goods and Services Tax Act, 2017.



On classification and rate of GST applicable to liquidated damages, that levy of GST on liquidated damages would be Para 5(e) of Schedule-II of the GST Act.

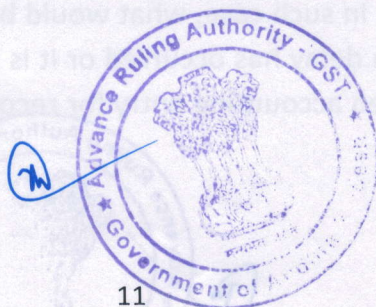
The following scheduled entry under the Notification No. 11/2017-Central/State Tax (Rate) [as amended from time to time] for taxable services would cover the impugned levy of liquidated damages

Sl. No. Chapter section

Heading Description of Service Rate (per cent) [CGST + SGST]

35	Heading 9997	Other services (washing, cleaning and dyeing services; beauty and physical well-being services; and other miscellaneous services including services nowhere else classified)	18% [9% + 9%]
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Another important issue of levy of GST is that at what time the liability to pay GST would occur. This would be governed by time of supply provision as stipulated in section 13 and 14 the GST Act. Section 13(1) provides that the liability to pay tax on services shall arise at the time of supply for which agreement and section 14 are relevant. Accordingly, liquidated damages are determined and imposed upon the contractor after in-depth study. In terms of the agreement, the clauses revealed that the levy of liquidated damages is not when the delay is occurring but the liability of payment of these liquidated damages by the Contractor will be established once the delay in successful execution of work is established on the part of the Contractor. This would define the time of supply. In terms of Section 13(1) of Central Goods and Services Tax Act, 2017, liability to pay tax on services arose at time of supply. If contractor fails to achieve execution of work within specified time period which falls under GST regime, then levy of liquidated damages would be attracted and this levy would attract GST levy. Section 14 of CGST Act should be referred to by the applicant



Liquidated damages if any collected/received under previously applicable Service Tax regime before coming into effect of GST, would be dealt with in accordance with the then existent provisions under applicable laws.

8. Ruling:

(Under section 98 of Central Goods and Services Tax Act, 2017 and the Andhra Pradesh Goods and Services Tax Act, 2017)

For reasons as discussed in the body of the order, the questions are answered, as under, in terms of the contract for material supply and turnkey contract {for "Design, Engineering and Supply of all equipment including commission spares and Insurance Spares for Indoor LBDS, HVLC and Interplant Cabling for which copies were provided by the applicant as sample agreements and as per the applicant all contract terms contain similar provisions pertaining to "Liquidated Damages" and other penalties like "milestone penalties" levied on suppliers/ contractors.

1) Whether "Liquidated Damages" and other penalties like milestone penalties levied on suppliers/ contractors in the nature of making good the damages for any delays in supply of service or goods in the following cases are exigible to GST or not?

(a) Supply and maintenance contracts

(b) Project construction contracts

In terms of the aforesaid contract agreement, GST would be applicable on the Liquidated Damages.

2) If GST is applicable, the following may kindly be clarified

(a) Whether the GST on Liquidated Damages, and other penalties is covered under Schedule II entry No. 5(2)(e) vide HSN code 9997 – Other services, for which the rate at 18% is relevant or any other entry is applicable?

In terms of the aforesaid agreement, schedule entry No.35 of the Notification No.11/2017 -Central/State Tax (Rate) [as amended from time to time] for taxable services would cover the impugned levy of liquidated damages.

(b) Liquidated damages are determined and imposed upon the contractor after in-depth study. In such case, what would be the time of supply? Will it be the period in which delay has occurred or it is the time when decision is taken or at the time when accounting entry for recovery is passed?



In terms of the aforesaid agreement, the clauses reveal that the levy of liquidated damages is , not when the delay is occurring but the liability of payment of these liquidated damages by the contractor will be established once the delay in successful execution of work is established on the part of the Contractor. This would define the time of supply.

- (c) When some part of the delay in supply has occurred before the implementation of the GST and some part of delay in supply has occurred after GST came into force, whether GST will be applicable to the Liquidated damages imposed for entire period of delay or it would be applicable only to the period falling after introduction of GST?

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

Sd/-D. RAMESH
Member (State Tax)

Sd/-S.NARASIMHA REDDY
Member (Central Tax)

//t.c.f.b.o//


Assistant Commissioner (ST)
Assistant Commissioner (State Tax)
O/o. Chief Commissioner of State Tax,
Andhra Pradesh, Vijayawada.

Copy to

1. M/s Rashtriya Ispat Nigam Ltd, Visakhapatnam Steel Plant, Visakhapatnam, A.P.,
(By Registered Post)
2. The Assistant Commissioner (ST), Steel Plant circle, Visakhapatnam Division.
(By Registered Post)
3. The Assistant Commissioner of Central Tax, Visakhapatnam South CGST Division,
Dwaraka Nagar, Visakhapatnam-530016 **(By Registered Post)**

Copy submitted to

1. The Chief Commissioner (State Tax), O/o Chief Commissioner of State Tax,
Eedupugallu, Vijayawada.
2. The Chief Commissioner (Central Tax), O/o Chief Commissioner of Central tax &
Customs, Visakhapatnam Zone, GST Bhavan, Port area,
Visakhapatnam-530035 **(By Registered Post)**

Note: Under Section 100 of the APGST Act 2017, an appeal against this ruling lies before the appellate authority for advance ruling constituted under section 99 of APGST Act 2017, with in a period of 30 days from the date of service of this order.

