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NITYA Insight | Issue 246 | Update on recent Circulars

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Recent Circulars

Circular 1: GST on liquidated damages, compensation and penalty arising out of breach of contract or other provisions of law

CBIC has issued Circular clarifying scope of Sl. No. 5(e) of Schedule II to the CGST Act. Vide this entry, 'Agreeing to an obligation to refrain from an act or to tolerate an act or a situation, or to do an act' is deemed as supply of service. Pertinently, this entry does not deem aforesaid transaction as supply. Therefore, for levy of GST, such transaction needs to constitute a **supply**.

The Circular discussed parameters for holding an activity falling under ambit of Sl. No. 5(e) to be a supply and clarifies taxability of various transactions which are debated in recent times. Important highlights of the Circular are as under:

A. Parameters for qualification of transaction as supply

- Sl. No. 5(e) of Schedule II has three limbs:
 - Obligation to refrain from an act (like non-compete agreements etc.);
 - Obligation to tolerate an act or a situation (like tolerating use of loudspeakers for morning prayers etc.); and
 - Obligation to do an act (like installation of pollution control equipment not otherwise mandated etc.)
- For levy of GST on these limbs, a contractual relationship in exchange for a consideration needs to necessarily exist. An activity without reciprocity of consideration (whether express or implied) will not qualify as supply.
- No presumption for existence of agreement can be made. Such agreement can be a standalone contract or part of any other contract.
- Amounts paid for preventing breach or non-performance of contract do not qualify as consideration for a supply and hence are not exigible to GST.

B. Examples of coverage and exclusions

- Circular excludes any deterrent penalty imposed in contractual relationships, compensation for non-performance etc. from purview of GST. The examples listed down in Circular, are tabulated below:

Exigible to GST	Excluded from purview of GST
Non-compete agreements	Liquidated damages for breach of contract
Abstaining from construction of more than certain number of floors	Penalty under Mining Act for excess stock found with mining company
Use of loudspeakers for early morning prayers	Notice pay recovery

Allowing hawker to use space	Penalty for cheque dishonor
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C. Clarifications on various types of payments

S. No.	Nature of payment	Reasoning
Supplies excluded from purview of GST		
1	Liquidated Damages ('LDs')	<ul style="list-style-type: none"> • Performance is essence of contract • Compensation is not consideration • LDs are not consideration for breach of contract but payments for not tolerating breach • LDs are awarded as deterrence for non-performance of contract
2	Compensation for cancellation of coal blocks	<ul style="list-style-type: none"> • Compensation given not under contract but pursuant to Supreme Court judgment • No agreement existed for agreeing or tolerating cancellation of coal blocks • Allotees had no option but for cancellation
3	Penalty for cheque dishonor	<ul style="list-style-type: none"> • Penalty is for deterring and discouraging this act and not for tolerating an act
4	Penalty for violation of laws	<ul style="list-style-type: none"> • Laws not framed for tolerating violation • No agreement exists between Government and violator
5	Notice pay recoveries or payment of bond amount	<ul style="list-style-type: none"> • Recovery is made to discourage non-serious candidates • Recovery is made as penalty for dissuading this act and not tolerating this act
6	Forfeiture of earnest money	<ul style="list-style-type: none"> • Forfeiture of earnest money of a successful bidder is a compensation for losses suffered and is not consideration. Hence, this is not exigible to GST.
<p>NITYA Comments: <i>The Circular is a welcome step as it will settle various litigations pending across judicial fora. This is particularly relevant in GST regime in the light of various adverse Advance Rulings upholding levy of GST on liquidated damages.</i></p> <p><i>This Circular is in line with views taken by NITYA since inception that GST & Service Tax is not leviable on activities intended to prevent an occurrence of event rather than promoting the same.</i></p>		
Supplies not covered under Sl. No. 5(e) but taxable otherwise		
7	Compensation for not collecting toll charges	<ul style="list-style-type: none"> • Payment remains to be for service of allowing access to road or bridge even if it is received from another party.
8	Late payment, surcharge or fee	<ul style="list-style-type: none"> • Late payment can be considered as payment for toleration of an act. However, as this amount is naturally bundled with principal supply, it should be assessed in same manner as principal supply.
9	Fixed capacity charges for power	<ul style="list-style-type: none"> • Minimum charges collected for supply of electricity is not towards toleration of an act but towards electricity supply only. Since electricity is exempt from GST, no GST is payable thereon.
10	Cancellation charges	<ul style="list-style-type: none"> • Forfeiture of deposits made for hotel accommodation,

		entertainment event or journey is towards intended supply and must be assessed in same manner as principal supply.
<p>NITYA Comments: <i>This Circular is incorrect to the extent it states that cancellation charges for services (like hotel accommodation etc.) is exigible to GST as supply of same service. As element of service is missing in such cases on same lines as clarified in other parts of this Circular, such cancellation charges should also not be considered as toleration of act nor exigible to GST.</i></p>		

Overall NITYA Comments: *While the Circular is overall favorable, it fails to provide clear-cut parameters and leaves room for intendments for determination as to whether a payments constitutes as consideration or not. Circular has made terms of contract and intent of parties relevant for determination of existence of supply. Hence, it will be important to analyze agreement between the parties and results may differ from case to case.*

Taxpayers can change their practice in future basis this Circular.

For FY 2021-22, taxpayers can also raise Credit Notes for outward supplies till September 2022. Taxpayers can also consider seeking refund for past period (where recipient was not entitled to ITC) subject to satisfaction of other conditions like limitation, unjust enrichment etc. for claiming refund. Notably, after recent refund extensions, refund for excess tax paid post July 2018 can be applied till August 20, 2022.

Circular No. 178/10/2022-GST dated **August 3, 2022**

Circular 2: Clarifications regarding transportation services

CBIC has issued Circular clarifying applicability of GST rates and exemption on various services in addition to the ones covered in minutes of the GST Council's 47th Meeting. Key clarifications regarding transportation services are discussed as under:

- The Circular has identified tests for highlighting difference between charter / hire / rental services and service of transportation of passengers / transportation of goods.
- The tests laid down by the Circular is that in case of charter / hire / rent, renter defines how & when vehicles will be operated and determines schedules, routes & other operational considerations. On the other hand, in transportation services, transportation takes place over pre-determined route on a pre-determined schedule.

Basis this, the Circular has concluded the following:

- In contracts for transport of minerals from mining pit head to railway siding or beneficiation plant, vehicles are given on hire to mining lease operator and cost of fuel is borne by recipient. The vehicles and driver are at disposal of recipient who defines how and when the vehicles will be operated. Hence, it is a service of rental of transport vehicles and not transportation of goods.
- RCM is payable by body corporate on renting of motor vehicles and not on passenger transportation service. Accordingly, where body corporate hires motor vehicle (for transport of employees etc.) for

a period of time during which motor vehicle remains at disposal of body corporate, RCM is applicable. However, RCM is not applicable where body corporate avails passenger transportation service for specific journeys or voyages.

In addition, Circular has also clarified as under:

- **Notification No. 12/2017-Central Tax (Rate)** dated **June 28, 2017** exempts transportation of passengers, with or without accompanied belongings, by non-air conditioned contract carriage.
- Such exemption will be available on 'passenger transportation service' received by companies and not hiring / renting of motor vehicle. Hence, exemption will be available where transportation of employees in a non-air-conditioned contract carriage is undertaken over pre-determined route on a pre-determined schedule.

NITYA Comments: While the Circular has dealt this aspect with respect to taxability and exemption, the test adopted by the Circular is also relevant from following two perspectives:

1. **ITC on passenger transportation service through vehicles** – Prior to February 2019, there was restriction of ITC on hiring / renting of all motor vehicles (including buses). However, there was no restriction for ITC on passenger transportation service. Many taxpayers claimed ITC basis tests laid down by this Circular i.e., ITC should be available where buses undertake transportation of employees on pre-determined route at a pre-determined schedule. The Circular has fortified this view.

Post February 2019, while ITC on buses is allowed in all cases, ITC is barred on renting of other vehicles and aircrafts. Hence, if a taxpayer satisfies test of passenger transportation service i.e., avails cars or aircrafts for pre-determined route and scheduled time, it can claim ITC as ITC on passenger transportation service is not barred.

2. **Exemption to hiring of motor vehicles for employee transportation** – Circular has clarified that hiring of non-AC contract carriage by taxpayers for transporting its employees to and from work is exempt. In many cases, taxpayers charge a subsidized price for providing such transportation. Similar exemption applies even on outward supply of transportation service to employees. Hence, complete leg of procurement and supply shall be exempt.

For FY 2021-22, taxpayers may avail ITC on inward supplies or raise Credit Notes for outward supplies till September 2022.

Circular No. 177/09/2022-TRU dated **August 3, 2022**

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NITYA
tax associates



CALL US

+91 11 4109 1200
+91 11 4109 1202



MAIL US

updates@nityatax.com
info@nityatax.com



REACH US

www.nityatax.com

Delhi:
B-3/58, Third Floor,
Safdarjung Enclave,
New Delhi – 110029

Mumbai:
91 Springboard Business Hub Private Limited
Plot No. D - 5, Road No. 20, Marol MIDC
Andheri East, Mumbai – 400093

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