CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
NEW DELHI

PRINCIPAL BENCH

SERVICE TAX APPEAL NO. 52226 OF 2019

(Arising out of Order-in-Original No. 22/Pr.COMMR/ST/BPL-I/2019 dated 27.03.2019 passed by Principal Commissioner, CGST & Central Excise, Bhopal)

M/s. The Madhya Pradesh State Mining, Corporation Limited, ...Appellant
Block 1, 2nd Floor, Paryawas Bhawan,
Arera Hills, Bhopal, Madhya Pradesh

versus

Pr. Commissioner, CGST & Central Excise, ...Respondent
35-C, GST Bhawan, Arera Hills, Jail Road,
Bhopal (M.P.) - 462011

APPEARANCE:

Shri B.L. Narasimhan and Shri Kunal Aggarwal, Advocates for the Appellant
Dr. Radhe Tallo, Authorized Representative for the Department

CORAM:

HON'BLE MR. JUSTICE DILIP GUPTA, PRESIDENT
HON'BLE MS. HEMAMBIKA R. PRIYA, MEMBER (TECHNICAL)

Date of Hearing: 24.03.2023
Date of Decision: 24.04.2023

FINAL ORDER NO. 50522/2023

Justice Dilip Gupta:

M/s. Madhya Pradesh State Mining Development Corporation[1] has filed this appeal to assail the order dated 27.03.2019 passed by the Principal Commissioner, CGST and Central Excise, Bhopal[2] confirming the demand of service tax with interest and penalty after invoking the extended the period of limitation contemplated under the proviso to section 73(1) of the Finance Act[3].

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1. **the appellant**
2. **the Principal Commissioner**
3. **the Finance Act**

2. The appellant was granted rights to mine sand, rock, phosphate, flag stone, and coal by the Madhya Pradesh State Government[4]. In lieu of these rights, the appellant was required to pay royalty to the State Government. The mining operations were carried out by the appellant either directly or through contractors for disposal of sand. In some cases, the appellant also formed joint ventures with the contractors to jointly undertake the mining operations.

3. Pursuant to audit objections, a show cause notice was issued to the appellant proposing a demand of service tax of Rs. 22,84,16,550/- with interest and penalty for the period from April 2013 to March 2017. This demand was confirmed by the order that has been impugned in this appeal.

4. The transactions with the corresponding allegations in the show cause notice and the findings in the order of the Principal Commissioner are tabulated below:

S. No.	**Issue**	**Transaction in dispute**	**Allegation in the show cause notice**	**Finding in the order**	**Disputed demand (in Rs.)**
1.	Non-payment of service tax on income from forfeiture and contractual adjustments	The agreement with contractor stipulates that the contractor would sell a decided quantity of sand from the mines of the appellant. Clause 4 of the contract states that the contractor would have to deposit the entire contracted sale value for the first year irrespective of the actual quantity of sale. If at the end of contract period, the actual quantity	That the amounts collected as „contractual adjustment" and „income from forfeiture" have been collected by the appellant as consideration either for the failure on the part of the contractors to honor the terms of the contract or for violating the terms of the contract. The amount booked as „other receipts" included aforesaid two amounts.	The appellant is recovering the amount of „contractual adjustment" as "**penalty**" on account of penal clause imposed on the contractor. Further, the appellant is recovering consideration in the name of **compensation/ penalty** from the contractors to tolerate contractor"s act of failure/ situation as per the contractual terms	21,33,83,731/-

4. **the State Government**

		lifted by contractor is less than the targeted quantity, then the amount already deposited by the contractor would be adjusted towards the deficient sale value, which is booked as „income from contractual adjustment". **- <u>Forfeiture of security deposit</u>** Clause 6 of the contract provides that the appellant can revoke the contract and forfeit the security deposit for reasoning such as fraud in obtaining tender, delay or refusal in making payments. These amounts are booked as „<u>income from forfeiture</u>" in the balance sheets.	These amounts are leviable to service tax under section 66E(e) of the Finance Act which fastens a tax liability on activity involving agreeing to the obligation to tolerate an act or situation or to do an act as a declared service.	& conditions. Such actions on part of the appellant constitutes a „declared service" under section 66E (e) of the Finance Act, making the amounts susceptible to service tax.	
2.	Non-payment of service tax on royalty paid to State Government under Reserve Charge Mechanism	By an agreement dated 2.1.2016, the State Government granted the appellant mining rights of sand, rock, phosphate, flag stone, and coal. For such rights, the appellant is required to pay royalty to the State Government. As per Part 5 of the agreement, the payment of royalty/dead rent/surface rent is subject to Rule 30 of M.P. Minor Minerals Rules, 1996.	The appellant has been paying royalty to the State Government for grant of mining rights. W.e.f. 01.04.2016, such services became taxable in the hands of service recipient and the appellant has started paying service tax. However, there is a short-payment of service tax on royalty during the relevant period. That the appellant"s contention that the short-paymentis to the extent of dead rent /surface rent, which are not taxable, cannot be accepted as the Balance Sheet has reflected there amounts as „royalty paid to government". Further, dead/surface rent is always adjusted against	That dead/surface rent paid to State Government is another form of royalty. The change in nomenclature is only to segregate the activity of mining from non-mining for the purpose of record maintenance. Hence, Service Tax is payable on such dead rent/ surface rent.	1,12,83,938/-

			royalty and paid in lieu of royalty. Thus, service tax is payable thereon under Reserve Charge Mechanism basis.		
3.	Non-payment of service tax on Director sitting fee	In terms of the agreement with JV Companies few executive/whole-time Directors of the appellant company were appointed as „nominee Director" in the J.V. Companies. The J.V. company has paid sitting fees to the said Directors (through the appellant) during the relevant period, on which service tax has been discharged by the JV companies.	The appellant received certain amount from the J.V. companies relating to the Directors" appointment in such J.V. companies. The appellant does not give the said amount to the Directors, and the amount is held by the appellant as income generated for services provided to its J.V. companies. Thus, the same is liable to service tax.	The amount from the JV Company was directly credited to the account of the appellant and not to the account of the Directors. Hence, the amount is in the form of income generated against providing services to the J.V. companies, on which the appellant is liable to discharge service tax.	78,863/-
4.	Non-payment of service tax on area development charges	Pursuant to the Order dated 30.12.1996 issued by State Government, the appellant was entitled to 30% of the area development charges receivable to State Government towards its administrative expenses.	As per the Order dated 08.04.1996 and the Order dated 30.12.1996, the appellant has to do several works and towards compensation for same, the appellant is entitled to retain 30% of amount collected for area development. This amount is against services provided by the appellant and hence appears liable to pay service tax.		36,70,018/-

5. Shri B.L. Narshiman assisted by Shri Kunal Aggarwal, learned counsel for the appellant made the following submissions:

(i) It is a settled position of law that liquidated damages recovered on account of breach or non-performance of contract are not consideration in lieu of any service but are in the nature of a deterrent imposed so that such a breach or non-performance is not repeated. In support of this contention learned

counsel placed reliance on the decision of the Tribunal in **South Eastern Coalfileds** vs. **Commissioner of Central Excise and Service Tax**[5], and to other decisions which have followed this decision;

(ii) The Circular 28.02.2023 issued by Central Board of Indirect Tax & Customs regarding leviability of service tax under section 66E(e) of the Finance Act also answers this issue in favour of the appellant;

(iii) Dead rent paid to State Government is not taxable since the taxable event occurred prior to April 2016;

(iv) Interest is not recoverable from the appellant nor penalty could have been imposed;

(v) The appellant is not liable to pay service tax on Directors fees paid by the joint venture company to its Directors; and

(vi) The appellant has not provided any service to the State Government against area development charges.

6. Dr. Radhe Tallo, learned authorized representative appearing for the Department, however, support the impugned order.

7. The submissions advanced by the learned counsel for the appellant and the learned authorized representative appearing for the Department have been considered.

8. The **first** issue relates to demand of service tax in respect of the following amount:

i. Amount booked as „contractual adjustments“ towards contractor“s failure to lift and sell the prescribed

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quantity of material from the mines during the currency of contract;

ii. Forfeiture of earnest money deposit on account of contractors failure to honor the terms of the contract like delayed/non-payment, further sale of material at more than the prescribed ceiling rate, execution of contract fraudulently by giving incorrect information; and

iii. Amount booked as other receipts which included aforesaid two amount.

9. The impugned order has observed that the appellant has received the amount as consideration for the failure on the part of the contractors to honor the terms of the contract or violating the conditions of the contract. Accordingly, the amount have been held to be taxable under clause (e) of section 66E of the Finance Act.

10. In **South Eastern Coalfileds**, the Tribunal held that liquidated damages recovered on account of breach or non-performance of contract are not consideration in view of any service but are in the nature of deterrent imposed so that such a breach or non-performance is not repeated. The relevant paragraphs of the decision of the Tribunal are reproduced below:

> "27. It is trite that an agreement has to be read as a whole so as to gather the intention of the parties. The intention of the appellant and the parties was for supply of coal; for supply of goods; and for availing various types of services. The consideration contemplated under the agreements was for such supply of coal, materials or for availing various types of services. The intention of the parties certainly was not for flouting the terms of the agreement so that the penal clauses get attracted. The penal clauses are in the nature of providing a safeguard to the commercial interest of the appellant and it cannot, by any stretch of imagination,

be said that recovering any sum by invoking the penalty clauses is the reason behind the execution of the contract for an agreed consideration. It is not the intention of the appellant to impose any penalty upon the other party nor is it the intention of the other party to get penalized.

28. It also needs to be noted that section 65B(44) defines -service to mean any activity carried out by a person for another for consideration. Explanation (a) to section 67 provides that -consideration includes any amount that is payable for the taxable services provided or to be provided. The recovery of liquidated damages/penalty from other party cannot be said to be towards any service per se, since neither the appellant is carrying on any activity to receive compensation nor can there be any intention of the other party to breach or violate the contract and suffer a loss. The purpose of imposing compensation or penalty is to ensure that the defaulting act is not undertaken or repeated and the same cannot be said to be towards toleration of the defaulting party. The expectation of the appellant is that the other party complies with the terms of the contract and a penalty is imposed only if there is non-compliance.

29. The situation would have been different if the party purchasing coal had an option to purchase coal from „A" or from „B" and if in such a situation „A" and „B" enter into an agreement that „A" would not supply coal to the appellant provided „B" paid some amount to it, then in such a case, it can be said that the activity may result in a deemed service contemplated under section 66E (e).

30. The activities, therefore, that are contemplated under section 66E (e), when one party agrees to refrain from an act, or to tolerate an act or a situation, or to do an act, are activities where the agreement specifically refers to such an activity and there is a flow of consideration for this activity.

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32. In the present case, the agreements do not specify what precise obligation has been cast upon the appellant to refrain from an act or tolerate an act or a

> situation. It is no doubt true that the contracts may provide for penal clauses for breach of the terms of the contract but, as noted above, there is a marked distinction between „conditions to a contract" and „considerations for a contract".

11. The Circular dated 28.02.2023 issued by the Central Board of Indirect Tax and Customs also provides that service tax cannot be levied on the amount collected for the said purpose and it is reproduced below:

> "4. As can be seen, the said expression has three libs: -i) Agreeing to the obligation to refrain from an act, ii) Agreeing to the obligation to tolerate an act or a situation, iii) Agreeing to the obligation to do an act. Service of agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act is nothing but a contractual agreement. **A contract to do something or to abstain from doing something cannot be said to have taken place unless there are two parties, one of which expressly or impliedly agrees to do or abstain from doing something and the other agrees to pay consideration to the first party for doing or abstaining from such an act. Such contractual arrangement must be an independent arrangement in its own right. There must be a necessary and sufficient nexus between the supply** (i.e. agreement to do or to abstain from doing something) **and the consideration**.
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> 5. **The issue also came up in the CESTAT in Appeal No. ST/50080 of 2019 in the case of M/s Dy. GM (Finance) Bharat Heavy Electricals** Ltd in which the Hon'ble Tribunal relied on the judgment of divisional bench in case of M/s South Eastern Coal Fields Ltd Vs. CCE Raipur (2021 (55) G.S.T.L 549(Tri-Del)). Board has decided not to file appeal against the CESTAT order ST/A/50879/2022-CU[DB] dated 20.09.2022 in this case and also against Order A/85713/2022 dated 12.8.2022 in case **of M/s Western Coalfields Ltd.** Further, Board has decided not to pursue the Civil Appeals filed before the Apex Court in M/s South Eastern Coalfields Ltd. supra (CA

> No. 2372/2021), M/s Paradip Port Trust (Dy. No. 24419/2022 dated 08-08-2022), and M/s Neyveli Lignite Corporation Ltd (CA No. 0051-0053/2022) on this ground.
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> 6. **In view of above, it is clarified that the activities contemplated under section 66E(e), i.e. when one party agrees to refrain from an act, or to tolerate an act or a situation, or to do an act, are the activities where the agreement specifically refers to such an activity and there is a flow of consideration for this activity.** Field formations are advised that while taxability in each case shall depend on facts of the case, the guidelines discussed above and jurisprudence that has evolved over time, may be followed in determining whether service tax on an activity or transaction needs to be levied treating it as service by way of agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act. Contents of Circular No. 178/10/2022-GST dated 3rd August, 2022, may also be referred to in this regard."
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> **(emphasis supplied)**

12. It is, therefore, not possible to sustain the demand.

13. The **second** category of demand pertains to the alleged short-payment of tax to the extent of dead rent/surface rent paid by the appellant to the State Government, which has been held to be taxable on reverse charge basis against the receipt of service concerning grant of mining rights.

14. The contention of the learned counsel for the appellant is that the demand is not sustainable as the service was received prior to 01.04.2016, when such services from the Government were not subject to tax.

15. The charging provision prescribing levy of tax is section 66B of the Finance Act and it is as follows:

> "**66B.** There shall be levied a tax (hereinafter referred to as the service tax) at the rate of fourteen per cent

> on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed."

16. Thus, for the purpose of levying service tax, the taxable event is construed as the time when the service is provided or agreed to be provided. Thus, in order to determine whether levy of tax is applicable on a particular activity, it is necessary to determine the point of time when such activity is provided or agreed to be provided. In the present case, the agreement between the appellant and State Government for grant of mining rights was executed on 02.01.2016 and on this date, the transactions involving assignment of right to use natural resource was not taxable.

17. In this connection section 66D of the Finance Act, as it existed prior to 01.04.2016, can be referred to and it is as follows:

> "**66D** The negative list shall comprise of the following services, namely:-
> (a) services by Government or a local authority excluding the following services to the extent they are not covered elsewhere-
> (i) services by the Department of Posts by way of speed post, express parcel post, life insurance and agency services provided to a person other than Government;
> (ii) services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport;
> (iii) transport of goods or passengers; or
> (iv) Support services, other than services covered under clauses (i) to (iii) above, provided to business entities"

18. Thus, prior to 01.04.2016, barring a few exceptions, all services provided by the Government were covered under the negative list and accordingly, not subjected to service tax.

19. With effect from 01.04.2016, however, section 66D(a)(iv) of the Finance Act was amended and 'all services provided by the government to a business entity were excluded from the negative list of services. Thus, services rendered by the government to a business entity became chargeable to service tax with effect from 01.04.2016.

20. In the present case, the appellant received services in relation to assignment of right to use natural resources from the State Government by virtue of the agreement dated 02.01.2016 and, therefore, the provisions of service tax, as were in force prior to 01.04.2016, would be applicable. Grant of natural resources was not excluded from the scope of negative list prior to 01.04.2016 and so no tax implication can be fastened on the appellant for such period.

21. The **third** issue that arises for consideration is regarding the fee paid to the Directors by the joint venture company. In this connection, it needs to be noted that the amount was only „held“ by the appellant on behalf of the joint venture/Directors and cannot be treated as income against provision of any service. Even otherwise, the transaction pertaining to this amount is between the joint venture company and the Directors and the appellant has no role to play.

22. The **fourth** issue that arises for consideration is whether the appellant provided any services to the State Government against the area development charges.

23. During the relevant period, the appellant received area development charges from the State Government to meet its administrative expenses. These amount have been paid pursuant to the order dated 30.12.1996 issued by State Government. The impugned order has sought to tax these amount by treating them as „consideration“ towards provision of taxable service.

24. It is not possible to sustain this view. For a service to be taxable, it is necessary that there should exists a service provider and service recipient relationship between the two parties. On a careful perusal of order dated 30.12.1996 issued by the State Government, it is apparent that the appellant was made entitled to 30% of the area development charges received by the State Government. These charges were paid to the appellant for meeting its administrative expenses, especially since the appellant is operating as a public sector undertaking of the State Government. There is no mention of any service which would be performed by the appellant in exchange of such amount. Thus, allocation of area development charges by the State Government can be regarded as income of the appellant, but it cannot be treated as consideration towards a service.

25. It is, therefore, not possible to sustain the impugned order dated 27.03.2019 passed by the Principal Commissioner. It is, accordingly, set aside and the appeal is allowed.

(Order pronounced on **24.04.2023**)

(JUSTICE DILIP GUPTA)
PRESIDENT

(HEMAMBIKA R. PRIYA)
MEMBER (TECHNICAL)

JB/Shreya