

Clarification by CBIC regarding GST Applicability on certain payments

CBIC vide circular no. 178/10/2022 dated August 03, 2022 issued certain clarifications regarding GST applicability on liquidated damages, compensation and penalty arising out of breach of contract or other provisions of law.

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. 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.

Liquidated Damages

Liquidated damages cannot be said to be a consideration received for tolerating the breach or non-performance of contract. They are rather payments for not tolerating the breach of contract. Such payments being merely flow of money are not a consideration

for any supply and are not taxable. However, amounts paid for acceptance of late payment, early termination of lease or for pre-payment of loan or the amounts forfeited on cancellation of service by the customer as contemplated by the contract as part of commercial terms agreed to by the parties, constitute consideration for the supply of a facility, namely, of acceptance of late payment, early termination of a lease agreement, of pre-payment of loan and of making arrangements for the intended supply by the tour operator respectively. Therefore, such payments, even though they may be referred to as fine or penalty, are actually payments that amount to consideration for supply, and are subject to GST, in cases where such supply is taxable.

Compensation for cancellation of coal blocks

There was no agreement between the prior allottees of coal blocks and the Government that the previous allottees shall agree to or tolerate cancellation of the coal blocks allocated to them if the Government pays compensation to them. No such promise or offer was made by the prior allottees to the Government. Therefore, the compensation paid for cancellation of coal blocks



pursuant to the order of the Supreme Court in the above case was not taxable.

Cheque dishonor fine/ penalty

The fine or penalty that the supplier or a banker imposes, for dishonour of a cheque, is a penalty imposed not for tolerating the act or situation but a fine, or penalty imposed for not tolerating, penalizing and thereby deterring and discouraging such an act or situation. Therefore, cheque dishonor fine or penalty is not a consideration for any service and not taxable.

Penalty imposed for violation of laws

Penalties imposed for violation of laws cannot be regarded as consideration charged by Government or a Local Authority for tolerating violation of laws. They stipulate penalty not for tolerating violation but for not tolerating, penalizing and deterring such violations. These amounts are not leviable to GST.

Forfeiture of salary or payment of bond amount in the event of the employee leaving the employment before the minimum agreed period

The said amounts are recovered by the employer not as a consideration for tolerating the act of such premature quitting of employment but as penalties for dissuading the non-serious employees from taking up employment and to discourage and deter such a situation. Therefore, such amounts recovered by the employer are not taxable as consideration for the service of agreeing to tolerate an act or a situation.

Late payment surcharge or fee

The facility of accepting late payments with interest or late payment fee, fine or penalty is a facility granted by supplier naturally bundled with the main supply. Since it is ancillary to and naturally bundled with the principal supply such as of electricity, water, telecommunication, cooking gas, insurance etc. it should be assessed at the same rate as the principal supply.

Fixed Capacity charges for Power

Both the components of the price, the minimum fixed charges/capacity charges and the variable/energy charges are charged for sale of electricity and are thus not taxable as electricity is exempt from GST.

Cancellation charges

Forfeiture of earnest money by a seller in case of breach of 'an agreement to sell' an immovable property by the buyer or such forfeiture by Government or local authority in the event of a successful bidder failing to act after winning the bid for allotment of natural resources, is a mere flow of money, as the buyer or the successful bidder does not get anything in return for such forfeiture of earnest money. Such payments being merely flow of money are not a consideration for any supply and are not taxable.

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