

Tax alert: Act of tolerating cheque dishonour constitutes a 'supply' and is liable to GST - Maharashtra AAAR

Issued on: 7 August 2019



Summary

The Maharashtra Appellate Authority for Advance Ruling (AAAR), in a recent case, has upheld the order of Maharashtra Advance Ruling Authority (AAR) that charges collected from the customers/ borrowers in case of bouncing/ dishonour of cheques, electronic/ other clearing mandate on ground of insufficiency of funds would constitute a supply, and hence attract GST. Further, refusing to consider the foreign judicial precedents referred to by the applicant, the AAAR has observed that such decisions are not binding on them and the entire issue on hand has been interpreted on the basis of provisions laid out under the GST laws.

Facts of the case

- The Applicant¹ is a non-banking financial company and is engaged in providing various interest bearing loans to customers.
- The loan agreements provide for repayment of loan in the form of Equated Monthly Instalments (EMI) through cheques/ Electronic Clearing System (ECS)/ National Automated Clearing House (NACH) or any other electronic or clearing mandate.
- In case of dishonour of cheque/ ECS/ NACH, the applicant collects penal/ bounce charges which are generally a fixed amount per default.
- The applicant had filed an advance ruling application before the Maharashtra AAR in relation to whether the bounce charges collected from customers should be treated as supply liable to GST.
- The Maharashtra AAR ruled² that the bounce charges collected by the applicant amounts to supply of services³ and is therefore liable to GST.
- Aggrieved by the said order, the applicant filed an appeal before the AAAR.

Applicant's contentions

- The impugned order is a non-speaking order as the Maharashtra AAR has failed to consider the submissions made by the applicant.
- Bounce charges collected by the applicant is not a consideration for any service, as they are merely damages for breach of contract by the customer. In the absence of any consideration, the bounce charges do not amount to supply under the GST laws⁴ and the same shall not be subject to GST.
- The definition of 'supply' under GST laws provides that certain activities⁵ shall be classified as supply of goods or services. However, the said provisions can be made applicable only when there is an agreement to the obligation to tolerate an act or situation and the word 'obligation' implies a duty or a liability on the person making the obligation with a corresponding right to the other person to enforce such obligation.
- However, in the present case, there is no obligation upon the applicant to tolerate an act of non-payment or delayed payment by the borrower.
- The payment of bounce charges neither obligates the applicant not to take any legal action against the borrower nor the borrower gains any right to sue the applicant for any legal action taken by the applicant.

¹ Bajaj Finance Limited

² Vide its order dated 6 August 2018

³ Under Sr. No. 5(e) of Schedule II to the CGST Act, 2017 wherein agreeing to the obligation to refrain from an act, or

to tolerate an act or a situation, or to do an act shall be treated as supply of services.

⁴ Under section 7 of the CGST Act, 2017

⁵ Referred in Schedule II to CGST Act read with Sr. No. 5(e) of Schedule II

- Therefore, the applicant submitted that the bounce charges payable by the borrower on the breach of its contractual obligation cannot be treated as a payment for any obligation on the applicant towards the borrower.
- Internationally also, damages received by way of compensation for termination or breach of contract are not treated as a supply and therefore not subject to GST/ VAT levy.
- Any treatment given to the main consideration for supply, ie interest on loan, shall also be applicable to penalty for delayed payment of such consideration, ie bounce charges. Hence, bounce charges would also be exempt from GST as in the case of interest on loans.

Maharashtra AAAR's observations and ruling

- The Maharashtra AAAR observed that the applicant has tolerated the act or situation of default by borrower of loan, against an agreed fixed amount/ charges and the same is adequately covered under the provisions of GST laws⁶.
- The AAAR opined that it is absolutely clear that act of tolerating cheque bounce/ dishonour is nothing but supply and 'bounce charges' is nothing but consideration.
- Therefore, the AAAR upheld the order of AAR and held that the 'bounce charges' collected from the customers/ borrowers in case of dishonour of instruments on ground of insufficiency of funds, would attract 'GST'.

- Further, the AAAR clarified that 'bounce charges' are recovered as a separate amount at a fixed rate under the head 'default interest' as stated in the loan agreement. Accordingly, it is excluded from the interest meant for the purpose of exemption⁷.
- The AAAR also refused to consider the overseas rulings referred to by the applicant stating that the rulings pronounced in overseas jurisdictions are not binding on the AAAR, and the entire issue has been interpreted on the basis of provisions laid out under the GST laws.

Our comments

The tax implications on penal charges levied by financial institutions in case of defaults by the borrowers has been a grey area and a matter of dispute. Pursuant to various representations from the trade and industry, the Central Board of Indirect Taxes (CBIC) has, vide Circular No. 102/21/2019-GST dated 28 June 2019, made an attempt to provide required clarity on the tax implications in case of penal charges/ additional interest. The CBIC has distinguished penal interest and other charges and clarified that such charges shall be leviable to GST.

6 Under Sr. No. 5(e) of Schedule II to the CGST Act, 2017

7 under Sr. No. 27 of Notification No. 12/2017 C.T. (Rate) dated June 28, 2017

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