CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL, MUMBAI
REGIONAL BENCH

Service Tax Appeal No. 347 of 2012

(Arising out of Order-in-Original No. 5/PKA/COMMR/TH-II/2012 dated 06.02.2012 passed by Commissioner of Service Tax-Thane-II)

M/s. LIC Housing Finance Ltd. **Appellant**
Bombay Life Building,
2nd floor, 45/47,
Veer Nariman Road,
Mumbai 400 001.

Vs.

Commissioner of S.T., Mumbai-I **Respondent**
5th floor, New Central Excise Bldg.,
M.K. Road, Churchgate,
Mumbai 400 020.

WITH

Service Tax Appeal No. 87431 of 2013

(Arising out of Order-in-Original No. 05/NG/COMMR/TH-II/2013 dated 04.03.2012 passed by Commissioner of Service Tax, Thane-II)

M/s. LIC Housing Finance Ltd. **Appellant**
Bombay Life Building,
2nd floor, 45/47,
Veer Nariman Road,
Mumbai 400 001.

Vs.

Commissioner of S.T., Mumbai-II **Respondent**
5th floor, New Central Excise Bldg.,
M.K. Road, Churchgate,
Mumbai 400 020.

WITH

Service Tax Appeal No. 87781 of 2013

(Arising out of Order-in-Original No. 34/ST/HB/12-13 dated 31.03.2012 passed by Commissioner of Service Tax, Mumbai)

M/s. LIC Housing Finance Ltd. **Appellant**
Bombay Life Building,
2nd floor, 45/47,
Veer Nariman Road,
Mumbai 400 001.

Vs.

Commissioner of S.T., Mumbai-I **Respondent**
5th floor, New Central Excise Bldg.,
M.K. Road, Churchgate, Mumbai 400 020.

AND

Service Tax Appeal No. 88057 of 2013

(Arising out of Order-in-Original No. 34/ST/HB/12-13 dated 31.03.2012 passed by Commissioner of Service Tax, Mumbai)

Commissioner of S.T., Mumbai-I **Appellant**
5th floor, New Central Excise Bldg.,
M.K. Road, Churchgate,
Mumbai 400 020.

Vs.

M/s. LIC Housing Finance Ltd. **Respondent**
Bombay Life Building,
2nd floor, 45/47,
Veer Nariman Road,
Mumbai 400 001.

Appearance:

Shri S.S. Gupta, C.A. for the Appellant
Shri M.K. Sarangi, Authorised Representative for the Respondent

CORAM:

Hon'ble Mr. S.K. Mohanty, Member (Judicial)
Hon'ble Mr. Sanjiv Srivastava, Member (Technical)

FINAL ORDER NO. A/**86425-86428/2019**

Date of Hearing: 01.05.2019
Date of Decision: 21.08.2019

PER: SANJIV SRIVASTAVA

The appeals as detailed below in table involve the common issue for consideration hence taken together:

	Appeal No	Order In Original No/ date	SCN Date	Period	Amount
1	ST/347/2012	5/PKA/COMMR/TH-II 06.02.12	07.10.08	10.3.04 –Mar 08	5,75,19,824
2	ST/87781/2013	34/ST/HB/12-13 31.03.13	16.10.09	Apr 08 – Mar 09	2,94,56,611
			26.09.10	Apr 09 – Mar 10	
			09.08.11	Apr 10 - Mar 11	
3	ST/88057/20		Revenue Appeal		

	13				
4	ST/87431/2013	5/NG/COMMR/TH-II 04.03.13	26.11.12	Apr 11 – Mar 12	88,59,196

By order at S No 1, adjudicating authority has confirmed the entire demand made by the Show Cause Notice dated 07.10.2008 along with Interest and imposed penalties under Section 76, 77 and 78 of Finance Act, 1994.

By order at S. No 2, adjudicating authority has confirmed the demand made by Show Cause Notice dated 16.10.2009, to extent of Rs 48.71 lakhs made by Show Cause Notice dated 26.09.2010. While dropping the demand of Rs 2.9 Crores made by the Show Cause Notice dated 26.09.2010 and Rs 3.91 Crores made under Show Cause Notice dated 09.08.2011, Commissioner has taken note of the amounts paid by the appellant against the demand made. He has dropped the penalties under all the three Show Cause Notices. Revenue has filed the appeal at S No 3 against the order of Commissioner dropping the penalties proposed.

By order at S No 4, adjudicating authority has confirmed the entire demand made by the Show Cause Notice dated 26.11.2012 along with Interest. No penalties proposed in the demand notice.

2.1 Appellants (M/s LIC Housing Finance Limited) are providing housing finance to individuals. After following the due procedure Housing Loan is sanctioned to the individual and agreement entered into with the borrower laying down the terms and conditions for grant of loan. The loan advanced is to be serviced by the borrower as per the equated monthly installments mentioned in the agreement.

2.2 The loan agreement extends the facility of prepayment of the loan amount to the borrower against a prepayment penalty of 2% whenever the borrower intends to make early pre-payment.

2.3 Proceeding were initiated against the appellants for demanding service tax on the prepayment penalty levied by them against early repayment of loan by the Show Cause Notices as indicated in table in para 1.

2.4 These show cause notice have been adjudicated by the Commissioner as per the orders as indicated in table in para 1.

2.5 Aggrieved by the order of Commissioner, appellants have filed appeals as mentioned at Serial No 1,2 and 4. Revenue has filed appeal at Sl No 3.

3.1 In their appeal Appellant have challenged the orders of Commissioner stating as follows:

- Pre payment charges recovered for the following reasons are in nature of penalty-
  - These are penalty charges levied to cover loss of interest;
  - Pre payment results in accumulation of excess funds and loss of interest on account as it disturbs the budgeting and forecasting planning of the appellant;
  - Is levied as penal charges so as to discourage movement of customer to other housing loan providers;
- Service Tax is leviable on amount which is received for the taxable service provided. The prepayment charges being in nature of penalty and not for provision of taxable service should not be subjected to service tax.
- By combined reading of provisions of Section 65 (12) (a) (ix) and Section 67 of Finance Act, 1994, would clearly show that the appellant is providing lending services to its customer, and only those amount which are collected for providing the said services can be included in the value of taxable services provided by them. Same has been clarified

by the CBEC vide Circular No 65/14/2003-ST dated 15.11.2003.

- Service Tax cannot be levied on the amount recovered as pre payment penalty charges as the same does not alter the value of taxable service provided by them. Since prepayment charges are in nature of penalty service tax cannot be levied in respect of these charges as per CBEC Circular No 32/3/2000-CX dated 12th December 2000
- Taxability under Service Tax will depend on the purpose of recovering the charges. As prepayment charges are not collected for the purpose of lending services the same are not taxable. Inclusion of pre-payment clause in the loan agreement does not imply that such charges have to treated as a value of taxable service. No relationship between the pre-payment charges and rendering of lending services has been established in the impugned orders therefore the same needs to be set aside.
- Recovery of prepayment charges cannot be equated with recovery of processing charges. Demand confirmed on such basis cannot survive.
- Prepayment charges are not recovered for performing any specific activities relating to closure of the loan, but are recovered for breach of the terms of the agreement and in order to compensate the future loss of interest and therefore cannot be treated as value of taxable service.
- Issue has been decided by the tribunal in case of Small Industries Development Bank of India [2011 (23) STR 392 (T-Del)] and the ratio laid down by the decision of HUDCO is distinguishable.
- Commissioner Service Tax Mumbai do not have any jurisdiction to issue the Show Cause Notice.
- Also the adjudication of the cases by the Commissioner Central Excise Thane II is also without jurisdiction.

- The demand made by invoking extended period of limitation is not justified as there was doubt in respect of leviability of service tax on these charges. Also none disclosure of nature of income cannot be reason for holding the charge of suppression. Also demand has been raised on the basis of Audit Objection.
- Section 80 of the Finance Act, 1994 empowers Central Excise officer not to impose penalty if the assessee proves that there was reasonable cause for nonpayment of service tax, since in the present case there was a reasonable cause the penalties should have been waived of.

3.2 In the appeal filed by revenue the order in original no 34/ST/HB/2013 dated 31.03.2013 has been challenged stating that-

- Adjudicating authority has confirmed the demand taking cognizance of CBEC's Circular F No 345/6/2008-TRU dated 11.06.2008 on the issue of pre closure/ fore closure charges under "Banking and Other Financial Services" as defined by Section 65(105)(zm) of the Finance Act, 1994, which clarified that pre-closure/ fore closure charges were not in the nature of interest but a part of consideration for the taxable service provided and hence the same attracted levy of service tax, stating that he was an authority subordinate to the CBEC and hence duty bound to follow the said clarification. Adjudicating authority erred in not appreciating that the scope of other financial services as defined under Section 65912)(a)(ix) read with Section 65(105)(zm) of the Finance act, 1994 interalia covered services in relation to lending, issue of pay order, demand draft, cheque, letter of credit. The scope of the said services include all the activities related to the lending upto the stage when the loan account of client is finally closed.

- Adjudicating authority erred in dropping the demand to the extent of Rs 2,90,29,012 (Notice dated 06.09.2010) and Rs 3,91,00,641/- (notice dated 11.08.2011) already paid by the appellant under protest. Adjudicating authority having confirmed the taxability of the said prepayment charges by following the CBEC Clarification dated 11.06.2008 ought to have held that the amounts paid by the appellants under protest, were legally recoverable from them as service tax dues under "Banking and Other Financial Services", instead of dropping the demand as not maintainable on the grounds that the provisions of Section 73(1) covered only service tax not levied or paid or short levied or short paid and that the said provisions did not cover situations where the service tax was paid by assessee.
- Adjudicating authority erred in not imposing penalty under Section 76 of Finance Act, 1994, on the ground that the service tax liability in respect of the said prepayment charges had arisen entirely on the account of Circular Dated 11.06.2008. Thus adjudicating authority concluded that the actions of the appellant were bonafide and honest is not correct as the liability to service tax has not arisen in view of the clarification issued but in terms of express provisions of law.

4.1 We have heard Shri S S Gupta, Chartered Accountant for the Appellants and Shri M K Sarangi, Additional Commissioner, Authorized Representative for the revenue.

4.2 Arguing for the appellants, learned Chartered Accountant submitted-

- Permitting foreclosure of loan or prepayment is not part of lending. Use of word 'namely' in the definition clause restricts the scope of other financial services to only those specified after the word 'namely'. Borrower at the time of obtaining loan is required to

make application for grant of loan. Thereafter they undertake verification of various documents viz bank statement, telephonic verification, employment verification etc, before sanctioning the loan. This the process of lending. In case of foreclosure or prepayment no such activity is done, only amount required to be paid as computed and flat 2% penalty is levied on the principal amount. Since no activity is carried out except computing the amount, foreclosure/ pre-payment is not part of lending activity. It is submitted that foreclosure is closing of loan where the entire amount is pre-paid. Therefore, the question of interest rate, tenure loan etc. is not at all relevant and the charges are not based on such on such factors. It is fixed at 2% of the amount. Thus prepayment charges are not for any activities carried out at the time of prepayment, permitting the borrower to pay the amount. It is for the damages recovered by the appellant.

- Foreclosure and prepayment charges are levied for ending the service and not for providing the service as held by tribunal in case of SIDBI [2011 (23) STR 392 (T-Del)].
- Decision of Housing & Development Corporation Ltd {2012 (26) STR 531 (T-Ahd)} will not be applicable to the present facts as in this case the appellants did not carry out any activity and the amount is levied as per the agreement entered into the parties. Therefore the said amount do not form the part of value of taxable service.
- Taking note of the difference in the views expressed in the above two decisions, matter was referred to larger bench. Taking note of the fact that issue in case of HUDCO is now pending before High Court, the matter was disposed of without answering the reference. Thus matter should be decided only after decision of High Court.

- The findings of Commissioner in impugned order in appeal No 347/12 and 84731/13 holding that prepayment charges are integral part of lending service is totally erroneous and no such activity is carried out.
- Impugned order in appeal No 87781/13 that these charges are not for performance of service but are in nature of penalty, hence not part of value of taxable service. However has gone ahead to confirm the demand relying on CBEC circular of 11.06.2008.
- In complaint filed by Neeraj Malhotra against levy of prepayment charges, Competition Commission of India has held as follows:

  "20.7 It is, therefore, clear that in regard to this issue the provisions of the Contract Act are attracted which clearly provide that in case of breach of a contract, the party which wants to exit has to pay for consequential loss/damage to the other party. Indeed, if this were not the case, wherever in any competitive market the price of a product comes down all the long-term contract buyers would like to break the contract, and if the product prices went up all the suppliers/sellers would like to exit. This kind of situation could create huge uncertainties in any product market, with inevitable negative macro-economic impact."

- The prepayment charges, charged by them from borrower are in nature of liquidated damages to recover the loss suffered by them, for the reason that this amount could not have been lended against the interest to other borrowers. [M/s Cheshire and Fifoot, 7th Edition, The Law of Contract page 561 to 565, Ansons Law of Contract 28th Edition J Beatson page 624 & 625, McGregor on Damages, 20th edition by James Edelman para 16.033 & 16.034 page 517 & 518]

- Issue on the payment of damages has been considered and decided by the Australian GST {Shaw V Director of Housing & Anor (No 2) [2001 ATC 4054]. Further in case of Ram Decorative & Industries Limited [2000 (124) ELT 659 (T)] it has been held that commitment charges collected from the buyers of excisable goods who failed to lift the entire quantity are in nature of liquidated damages and not includible in assessable value.
- Prepayment penalty have no nexus with the service s of lending and thus are not subject to service tax in view of the decision of Apex Court in case of Intercontinental Consultants and Technocrats Pvt Ltd [2018 (10) GSTL 401 (SC)]. CBE has vide circular No 94/5/2007-ST dated 05.05.2007 clarified in respect of mutual funds that entry and exit load amount recovered by the mutual fund had the nexus to the initial issue expense incurred by the mutual fund and has no nexus to the services supplied by mutual fund, thus will not for the part of value of taxable service.
- Prepayment charges are in nature of penalty as per following authorities-
    - RBI circular dated 26.06.2012
    - RBI circular dated 13.08.2012
    - Circular of National Housing Bank

  CBEC has by following circulars clarified that the penalty amount do not form the part of value of taxable service. [Circular No 32/3/2000-CX dated 20.12.2000, Circular No 121/2/2010-ST dated 26.04.2010
- Section 73 and 74 of Indian Contract Act provides for recovery of damages and service tax is not applicable on such damages.
- Prepayment charges are inclusive of service tax and hence the benefit of Section 67(2) should have been extended to them.

- They had reasonable belief that no tax is payable. During the relevant period i.e 10.09.2004 to 31.03.2008 there was no requirement to declare the value of exempt services under the ST-3 Return. The format of return also did not provided for such disclosure. Appellants had not interpreted the law by themselves. The issue in view of disputes was referred to larger bench in case of Small Industrial Development Bank of India [2015 (38) STR 666 (T)] hence the demand upto 31.03.2007 is time barred as the Show Cause Notice demanding Service Tax was issued on 16.10.2008. [Continental Foundation Jt Venture [2017 (216) ELT 177 (SC)]
- Since tax with was paid as detailed in table below and should have been appropriated towards the demand of service tax.

Appeal No	Period	Amount Paid	Intimation Details
ST/347/2012	10.09.04 to 31.03.08	5,75,19,824	Letter dated 11.05.12
ST/87781/2013	01.04.08 to 04.06.09	3,24,29,768	Letter dated 21.11.12
	05.06.09 to 31.03.11	2,90,29,012	Paid on Monthly basis under protest
ST/87431/2012	2011-12	88,59,196	Paid and Appropriated in impugned order
	Total	12,78,37,800	

- The penalty levied under Section 76, 77 & 78 should have not been levied in view of the provisions contained in Section 80 of the Finance Act, 1994

4.3 Arguing for the revenue learned Authorized Representative submitted that-

- issue in respect of levy of Service Tax, on the prepayment charges has been considered and de4cided by the tribunal in case of HUDCO [2012

(26) STR 531 (T-Ahd)]. In the loan agreement for there is nothing mentioned that the amount so collected is penalty rather than a charge levied;

- decision of HUDCO has been rendered after considering and distinguishing the decision in case of SIDBI [2011 (23) STR 392 (T-Del)]. Hence it is not correct to state that two conflicting views were there;
- The issue before the Competition Commission in case of Neeraj Malhotra was whether levying prepayment charge restrict the competition among Banks interest, which has been justified by Banks for asset liability management, and it was not deciding service tax liability on the said amount. As per finding in para 1.21 of the said decision, it can be "Cyclical prepayment", in case of drop in interest rates, and structural prepayment in case of rising interest rate. So the pleading of appellant that the said charges levied for loss suffered by them, as surplus funds have to be redeployed by tem at lesser interest rate do not appear to be correct. As per
    - para 18.9 *"It is not penal in nature but is aimed to regulate cost of funds and is within fair practice guidelines of RBI"*;
    - para 20.4, gives a clear view that costs/ prices to be charged in a competitive market are determined by the market and is not an issue to be determined by competition regulator, which show limited mandate before the authority.
- Appeal ground taken by appellant that prepayment levy is in nature of penalty to recover loss of interest and discouraging shifting of borrower to other banks is self contradictory in the sense that as per competition commission proceedings relied by them there is no restriction on competition among banks interest and further it is not in nature of penalty. As

per finding of Commission prepayment can be both in case falling interest rate and rising interest rate, hence pre paid amount can be deployed by banks at higher yield to new investors.

- Circular relied by appellant w r t payments, if applied to present situation, there should be refund on interest by Banks to customers, and similar view has been taken by tribunal in HUDCO case, as there has been pre payment. In facts as per business practice followed normally, if any utility bill is settled before the due date, the consumer is offered discount on total amount.
- Appellants have failed to intimate Deptt, and file ST-3 return disclosing the said transaction and did not pay S Tax, extended period has been invoked and penalty has been imposed. On limitation - nonpayment of Service Tax was found during audit. The relevant question is whether the appellant have truly disclosed the taxable activity and revenue had knowledge of the affairs of the company before the audit. {Reliant advertising [2013 (31) STR 166 (T-Del)], Vodafone Digilink [2011 (24) STR 562 (T-Del)], BSNL [2011-TIOL-552-CESTAT-MUM], Rennaissance Leasing & Finance Pvt Ltd [2017 (52) STR 4 (T-Del)], Lakhan Singh [2016 (46) STR 297 (T-Del)]}

5.1 We have considered the impugned order along with the submissions made in appeal and during the course of argument of appeal.

5.2 Undisputedly Appellants had extended the benefit of pre-payment for the foreclosure of the loan extended by it to the their clients. Para 7(b) and 7(c) of the Loan agreement reads as follows:

"7(b).You will be at liberty to make either full payment or part payment towards the Principal in multiples of Rs 2000/- 9Rupees Two Thousand only) at any time after the expiry of 6 months from the date of disbursement of the

loan or the first installment thereof, provided, however, that no installment of Interest/ EMI is in arrears on the date of payment and provided further that such payment will not interfere with, or affect the payment in due course of the subsequent monthly installments of Interest/ Additional Interest or EMI's, if any. ***Such prepayment shall carry Levy Charge of 2% of the amount prepaid. Further, Interest for the full month calculated on the amount of loan outstanding at the beginning of the month will be payable, Irrespective of the date of payment of part/full Principal.*** *Also where offered in repayment is 25% of the Loan outstanding or Rs 10,000/- whichever is less, the subsequent EMIs may be rescheduled at the discretion of the Company, In such an event EMI will be recalculated on the amount of loan outstanding as at the end of the month in which the payment is made for the remaining period of the loan.*

7(c) "Where the loan is under Sampurna Griha-B Scheme you will be at liberty to make part payments of Rs 10,000/- or more provided however that no installments due is in arrears on the date of such payment and provided that such payment in anticipation will not interfere with or affect the payment in due course of subsequent monthly installments due."

5.3 From the above provisions in the loan agreement it is quite evident that appellants are extending the option of prepayment-

- at the time of entering into loan agreement with their customer;
- the facility of prepayment is extended subject to levy of charge of 2% of the amount prepaid.
- the facility of prepayment though extended is optional, and the customer has option to exercise the same subject to terms and conditions.

It is thus quite evident the facility of prepayment, has been extended at the time of entering into the loan agreement and agreement itself allows against payment of certain “levy charges”. The levy charges are for exercising the option which has been extended by the appellant. These charges are not towards any default on the behalf of customer.

5.4 Such options are not something new. Financial Instruments such as the loan agreement often extend such options against a price. As per *http://www.economywatch.com/options-and-futures/financial-options. html, “***Financial options** *are those derivatives contracts in which the underlying assets are financial instruments such as stocks, bonds or an interest rate. The options on financial instruments provide a buyer with the right to either buy or sell the underlying financial instruments at a specified price on a specified future date. Although the buyer gets the rights to buy or sell the underlying options, there is no obligation to exercise this option. However, the seller of the contract is under an obligation to buy or sell the underlying instruments if the option is exercised.”* Since the levy charges are in nature of charge towards the exercise of an option extended by the loan agreement, appellants submission that these charges are penalty cannot be acceded to. There is a interesting distinction laid down by the UK Supreme Court in case of *Cavendish Square Holdings BV v. Makdessi and ParkingEye Ltd v. Beavis, reported together at [2015] UKSC 67*.

“What makes a contractual provision penal?

19. As we have already observed, until relatively recently this question was answered almost entirely by reference to straightforward liquidated damages clauses. It was in that context that the House of Lords sought to restate the law in two seminal decisions at the beginning of the 20th century, Clydebank in 1904 and Dunlop in 1915.

20. Clydebank was a Scottish appeal about a shipbuilding contract with a provision (described as a "penalty") for the payment of £500 per week for delayed delivery. The provision was held to be a valid liquidated damages clause, not a penalty. Lord Halsbury (p 10) said that the distinction between the two depended on

"whether it is, what I think gave the jurisdiction to the courts in both countries to interfere at all in an agreement between the parties, unconscionable and extravagant, and one which no court ought to allow to be enforced."

Lord Halsbury declined to lay down any "abstract rule" for determining what was unconscionable or extravagant, saying only that it must depend on "the nature of the transaction – the thing to be done, the loss likely to accrue to the person who is endeavouring to enforce the performance of the contract, and so forth". Lord Halsbury's formulation has proved influential, and the two other members of the Appellate Committee both delivered concurring judgments agreeing with it. It is, Page 10 however, worth drawing attention to an observation of Lord Robertson (pp 19-20) which points to the principle underlying the contrasting expressions "liquidated damages" and "penalty":

"Now, all such agreements, whether the thing be called penalty or be called liquidate damage, are in intention and effect what Professor Bell calls 'instruments of restraint', and in that sense penal. But the clear presence of this does not in the least degree invalidate the stipulation. The question remains, had the respondents no interest to protect by that clause, or was that interest palpably incommensurate with the sums agreed on? It seems to me that to put this question, in the present instance, is to answer it."

21. Dunlop arose out of a contract for the supply of tyres, covers and tubes by a manufacturer to a garage. The contract contained a number of terms designed to protect

the manufacturer's brand, including prohibitions on tampering with the marks, restrictions on the unauthorised export or exhibition of the goods, and on resales to unapproved persons. There was also a resale price maintenance clause, which would now be unlawful but was a legitimate restriction of competition according to the notions prevailing in 1914. It was this clause which the purchaser had broken. The contract provided for the payment of £5 for every tyre, cover or tube sold in breach of any provision of the agreement. Once again, the provision was held to be a valid liquidated damages clause. In his speech, Lord Dunedin formulated four tests "which, if applicable to the case under consideration, may prove helpful, or even conclusive" (p 87). They were (a) that the provision would be penal if "the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach"; (b) that the provision would be penal if the breach consisted only in the non-payment of money and it provided for the payment of a larger sum; (c) that there was "a presumption (but no more)" that it would be penal if it was payable in a number of events of varying gravity; and (d) that it would not be treated as penal by reason only of the impossibility of precisely pre-estimating the true loss.

22. Lord Dunedin's speech in Dunlop achieved the status of a quasi-statutory code in the subsequent case-law. Some of the many decisions on the validity of damages clauses are little more than a detailed exegesis or application of his four tests with a view to discovering whether the clause in issue can be brought within one or more of them. In our view, this is unfortunate. In the first place, Lord Dunedin proposed his four tests not as rules but only as considerations which might prove helpful or even conclusive "if applicable to the case under consideration". He did not suggest that they were applicable to every case in which the law of penalties was

engaged. Second, as Lord Dunedin himself acknowledged, the essential question was whether the clause impugned was "unconscionable" or "extravagant". The four tests are a useful tool for deciding whether these expressions can properly be applied to simple damages clauses in standard contracts. But they are not easily applied to more complex cases. To deal with those, it is necessary to consider the rationale of the penalty rule at a more fundamental level. What is it that makes a provision for the consequences of breach "unconscionable"? And by comparison with what is a penalty clause said to be "extravagant"? Third, none of the other three Law Lords expressly agreed with Lord Dunedin's reasoning, and the four tests do not all feature in any of their speeches. Indeed, it appears that, in his analysis at pp 101-102, Lord Parmoor may have taken a more restrictive view of what constituted a penalty than did Lord Dunedin. More generally, the other members of the Appellate Committee gave their own reasons for concurring in the result, and they also repay consideration. For present purposes, the most instructive is that of Lord Atkinson, who approached the matter on an altogether broader basis.

23. Lord Atkinson pointed (pp 90-91) to the critical importance to Dunlop of the protection of their brand, reputation and goodwill, and their authorised distribution network. Against this background, he observed (pp 91-92):

"It has been urged that as the sum of £5 becomes payable on the sale of even one tube at a shilling less than the listed price, and as it was impossible that the appellant company should lose that sum on such a transaction, the sum fixed must be a penalty. In the sense of direct and immediate loss the appellants lose nothing by such a sale. It is the agent or dealer who loses by selling at a price less than that at which he buys, but the appellants have to look at their trade in globo, and to prevent the setting up, in reference to all their goods anywhere and everywhere, a

system of injurious undercutting. The object of the appellants in making this agreement, if the substance and reality of the thing and the real nature of the transaction be looked at, would appear to be a single one, namely, to prevent the disorganization of their trading system and the consequent injury to their trade in many directions. The means of effecting this is by keeping up their price to the public to the level of their price list, this last being secured by contracting that a sum of £5 shall be paid for every one of the three classes of articles named sold or offered for sale at prices below those named on the list. The very fact that this sum is to be paid if a tyre cover or tube be merely offered for sale, though not sold, shows that it was the consequential injury to their trade due to undercutting that they had in view. They had an obvious interest to prevent this undercutting, and on the evidence it would appear to me impossible to say that that interest was incommensurate with the sum agreed to be paid."

Lord Atkinson went on to draw an analogy, which has particular resonance in the Cavendish appeal, with a clause dealing with damages for breach of a restrictive covenant on the canvassing of business by a former employee. In this context, he said (pp 92-93):

"It is, I think, quite misleading to concentrate one's attention upon the particular act or acts by which, in such cases as this, the rivalry in trade is set up, and the repute acquired by the former employee that he works cheaper and charges less than his old master, and to lose sight of the risk to the latter that old customers, once tempted to leave him, may never return to deal with him, or that business that might otherwise have come to him may be captured by his rival. The consequential injuries to the trader's business arising from each breach by the employee of his covenant cannot be measured by the direct loss in a monetary point of view on the particular transaction constituting the breach."

Lord Atkinson was making substantially the same point as Lord Robertson had made in Clydebank. The question was: what was the nature and extent of the innocent party's interest in the performance of the relevant obligation. That interest was not necessarily limited to the mere recovery of compensation for the breach. Lord Atkinson considered that the underlying purpose of the resale price maintenance clause gave Dunlop a wider interest in enforcing the damages clause than pecuniary compensation. £5 per item was not incommensurate with that interest even if it was incommensurate with the loss occasioned by the wrongful sale of a single item.

24. Although the other members of the Appellate Committee did not express themselves in the same terms as Lord Atkinson, their approach was entirely consistent with his. Lord Parker at p 97 said that "whether the sum agreed to be paid on the breach is really a penalty must depend on the circumstances of each particular case", and at p 99, echoing Lord Atkinson's fuller treatment of the point, as just set out, he described the damage which would result from any breach as "consist[ing] in the disturbance or derangement of the system of distribution by means of which [Dunlop's] goods reach the ultimate consumer". In their speeches, Lord Dunedin (p 87), Lord Parker (p 98) and Lord Parmoor (p 103) ultimately were content to rest their decision that the £5 was not a penalty on the ground that an exact pre-estimate of loss was impossible, whereas, in the passages quoted above, Lord Atkinson analysed why that was so. It seems clear that the actual result of the case was strongly influenced by Lord Atkinson's reasoning. The clause was upheld although, on the face of it, it failed all but the last of Lord Dunedin's tests. The £5 per item applied to breaches of very variable significance and it was impossible to relate the loss attributable to the sale of that item. It was justifiable only by reference to the wider interests identified by Lord Atkinson.

25. The great majority of cases decided in England since Dunlop have concerned more or less standard damages clauses in consumer contracts, and Lord Dunedin's four tests have proved perfectly adequate for dealing with those. More recently, however, the courts have returned to the possibility of a broader test in less straightforward cases, in the context of the supposed "commercial justification" for clauses which might otherwise be regarded as penal. An early example is the decision of the House of Lords in The "Scaptrade", where at p 702, Lord Diplock, with whom the rest of the Appellate Committee agreed, observed that a right to withdraw a time-chartered vessel for non-payment of advance hire was not a penalty because its commercial purpose was to create a fund from which the cost of providing the chartered service could be funded.

26. In Lordsvale Finance plc v Bank of Zambia [1996] QB 752, Colman J was concerned with a common form provision in a syndicated loan agreement for interest to be payable at a higher rate during any period when the borrower was in default. There was authority that such provisions were penal: Lady Holles v Wyse (1693) 2 Vern 289; Strode v Parker (1694) 2 Vern 316, Wallingford v Mutual Society (1880) 5 App Cas 685, 702 (Lord Hatherley). But Colman J held that the clause was valid because its predominant purpose was not to deter default but to reflect the greater credit risk associated with a borrower in default. At pp 763-764, he observed that a provision for the payment of money upon breach could not be categorised as a penalty simply because it was not a genuine pre-estimate of damages, saying that there would seem to be:

"no reason in principle why a contractual provision the effect of which was to increase the consideration payable under an executory contract upon the happening of a default should be struck down as a penalty if the increase could in the circumstances be explained as commercially

justifiable, provided always that its dominant purpose was not to deter the other party from breach."

27. Colman J's approach was approved by Mance LJ, delivering the leading judgment in the Court of Appeal in Cine Bes Filmcilik ve Yapimcilik v United International Pictures [2004] 1 CLC 401, para 13. A similar view was taken by Arden LJ in Murray v Leisureplay plc [2005] IRLR 946, para 54, where she posed the question

"Has the party who seeks to establish that the clause is a penalty shown that the amount payable under the clause was imposed in terrorem, or that it does not constitute a genuine pre-estimate of loss for the purposes of the Dunlop case, and, if he has shown the latter, is there some other reason which justifies the Page 14 discrepancy between [the amount payable under the clause and the amount payable by way of damages in common law]?" (emphasis added).

She considered that the clause in question had advantages for both sides, and pointed out that no evidence had been adduced to show that the clause lacked commercial justification: see paras 70-76. But Buxton LJ put the matter on a wider basis for which Clarke LJ (para 105) expressed a preference. He referred to the speech of Lord Atkinson in Dunlop and suggested that the ratio of the actual decision in that case had been that "an explanation of the clause in commercial rather than deterrent terms was available". All three members of the court endorsed the approach of Colman J in Lordsvale and Mance LJ in Cine Bes.

28. Colman J in Lordsvale and Arden LJ in Murray were inclined to rationalise the introduction of commercial justification as part of the test, by treating it as evidence that the impugned clause was not intended to deter. Later decisions in which a commercial rationale has been held inconsistent with the application of the penalty rule, have tended to follow that approach: see, for example, Euro

London Appointments Ltd v Claessens International Ltd [2006] 2 Lloyd's Rep 436, General Trading Company (Holdings) Ltd v Richmond Corpn Ltd [2008] 2 Lloyd's Rep 475. It had the advantage of enabling them to reconcile the concept of commercial justification with Lord Dunedin's four tests. But we have some misgivings about it. The assumption that a provision cannot have a deterrent purpose if there is a commercial justification, seems to us to be questionable. By the same token, we agree with Lord Radcliffe's observations in Campbell Discount at p 622, where he said:

"… I do not myself think that it helps to identify a penalty, to describe it as in the nature of a threat 'to be enforced in terrorem' (to use Lord Halsbury's phrase in Elphinstone v Monkland Iron & Coal Co Ltd (1886) 11 App Cas 332, 348). I do not find that that description adds anything of substance to the idea conveyed by the word 'penalty' itself, and it obscures the fact that penalties may quite readily be undertaken by parties who are not in the least terrorised by the prospect of having to pay them and yet are, as I understand it, entitled to claim the protection of the court when they are called upon to make good their promises."

Moreover, the penal character of a clause depends on its purpose, which is ordinarily an inference from its effect. As we have already explained, this is a question of construction, to which evidence of the commercial background is of course relevant in the ordinary way. But, for the same reason, the answer cannot depend on evidence of actual intention: see Chartbrook Ltd v Persimmon Homes Ltd [2009] AC 1101, paras 28-47 (Lord Hoffmann). However, while we have misgivings about some aspects of their reasoning, these aspects are peripheral to the essential point which Colman J and Buxton LJ were making, and we consider that their emphasis on justification provides a valuable insight into the real basis of the penalty rule. It is the same insight as

that of Lord Robertson in Clydebank and Lord Atkinson in Dunlop. A damages clause may properly be justified by some other consideration than the desire to recover compensation for a breach. This must depend on whether the innocent party has a legitimate interest in performance extending beyond the prospect of pecuniary compensation flowing directly from the breach in question.

30. More generally, the attitude of the courts, reflecting that of the Court of Chancery, is that specific performance of contractual obligations should ordinarily be refused where damages would be an adequate remedy. This is because the minimum condition for an order of specific performance is that the innocent party should have a legitimate interest extending beyond pecuniary compensation for the breach. The paradigm case is the purchase of land or certain chattels such as ships, which the law recognises as unique. Because of their uniqueness the purchaser's interest extends beyond the mere award of damages as a substitute for performance. As Lord Hoffmann put it in addressing a very similar issue "the purpose of the law of contract is not to punish wrongdoing but to satisfy the expectations of the party entitled to performance": Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd [1998] AC 1, 15.

31. In our opinion, the law relating to penalties has become the prisoner of artificial categorisation, itself the result of unsatisfactory distinctions: between a penalty and genuine pre-estimate of loss, and between a genuine pre-estimate of loss and a deterrent. These distinctions originate in an over-literal reading of Lord Dunedin's four tests and a tendency to treat them as almost immutable rules of general application which exhaust the field. In Legione v Hateley (1983) 152 CLR 406, 445, Mason and Deane JJ defined a penalty as follows:

"A penalty, as its name suggests, is in the nature of a punishment for non-observance of a contractual stipulation; it consists of the imposition of an additional or

different liability upon breach of the contractual stipulation ..."

All definition is treacherous as applied to such a protean concept. This one can fairly be said to be too wide in the sense that it appears to be apt to cover many provisions which would not be penalties (for example most, if not all, forfeiture clauses). However, in so far as it refers to "punishment" and "an additional or different liability" as opposed to "in terrorem" and "genuine pre-estimate of loss", this definition seems to us to get closer to the concept of a penalty than any other definition we have seen. The real question when a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss. These are not natural opposites or mutually exclusive categories. A damages clause may be neither or both. The fact that the clause is not a pre-estimate of loss does not therefore, at any rate without more, mean that it is penal. To describe it as a deterrent (or, to use the Latin equivalent, in terrorem) does not add anything. A deterrent provision in a contract is simply one species of provision designed to influence the conduct of the party potentially affected. It is no different in this respect from a contractual inducement. Neither is it inherently penal or contrary to the policy of the law. The question whether it is enforceable should depend on whether the means by which the contracting party's conduct is to be influenced are "unconscionable" or (which will usually amount to the same thing) "extravagant" by reference to some norm.

32. The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. In the case of a straightforward damages

clause, that interest will rarely extend beyond compensation for the breach, and we therefore expect that Lord Dunedin's four tests would usually be perfectly adequate to determine its validity. But compensation is not necessarily the only legitimate interest that the innocent party may have in the performance of the defaulter's primary obligations. This was recognised in the early days of the penalty rule, when it was still the creature of equity, and is reflected in Lord Macclesfield's observation in Peachy (quoted in para 5 above) about the application of the penalty rule to provisions which were "never intended by way of compensation", for which equity would not relieve. It was reflected in the result in Dunlop. And it is recognised in the more recent decisions about commercial justification. And, as Lord Hodge shows, it is the principle underlying the Scottish authorities."

5.5 The above quoted English decision clearly lays down what can be called a penalty clause under the contractual obligation and the decision has been rendered after considering the law/ decision as have emerged on the subject across the world. In our view the fees for option to prepay cannot be termed as penalty in terms of penalty rule as has been laid down and discussed extensively in the above quoted decision. We also do not find any merits in the submissions of the appellants relying on the RBI Circular dated 26.06.2012 and 13.08.2012 that these charges are in nature of penalty. These circular do not state so. Since we are not in agreement with the submissions of the appellant that these charges are in nature of penalty hence the Borad Circular No 32/3/200-CX dated 20.12.2000 and Circular No 121/2/2010-ST dated 26.04.2010 will not be applicable to the facts of present case.

5.6 Appellants have vehemently submitted that the commitment charges are in nature of interest charges or the damage charges made by them from their customer/ client for making available the said credit facility available

to them. Since these are in nature of interest/ damages they are not to be included in the value of taxable services provided by them.

5.7 In view of the discussions as above and established practices in banking and financial industry we do not find any merits in the submissions of the appellant that the prepayment levy charged by them for foreclosure of loan is interest charge or in nature of liquidated damages. The basic nature of interest as is understood in the banking and financial industry is that its time value of the money held by the other person. In the case of foreclosure the customer is not holding any money of the appellant, but is returning back the same much before the appointed date. Hence the return of money cannot be subject to interest charge as claimed by the appellant, nor can it be the damages as claimed by them.

5.8 Appellants have relied on the decision of the Competition Commission of India in case of Neeraj Malhotra. The Competition Commission has itself in para 20.3 and 20.4 observed as follows:

"20.3 Once the borrower has made the choice fully, he/she enters into a contractual agreement with the selected bank/HFC. Provisions in regard to PPC, if any, are part of this agreement. This agreement so entered into is entirely voluntary, with full knowledge of all the provisions, and cannot be in any way confused with an agreement entered into without choice due to abuse of dominance by a provider of goods/services attracting the provisions of Section 4 of the Act.

20.4 Coming to the decision to exit mentioned in para (b) above, the borrower is free to exit subject to paying the PPC. Thus the exit is not prohibited, and only has a cost attached to it. The reasons and justification given for this cost have been covered earlier, including being on account of cost incurred due to loss of interest, holding cost of money till it is redeployed, possibility of fresh deployment

being at a lower interest rate (since switching typically is resorted to by borrowers in a falling interest rate regime) etc. This part of the transaction has, therefore, to be seen in terms of the Indian Contract Act, 1872, since the costs/prices to be charged in a competitive market are determined by the market and is not an issue to be determined by a competition regulator. This would become a competition issue only if this is sought to be manipulated through anti-competitive agreement(s) or abuse of dominance. It is, therefore, necessary to take up a harmonious construction of Competition Act, 2002 and Indian Contract Act, 1872…"

In our view Competition Commission itself has held that prepayment charges are in nature of cost imposed for permitting the early exit.

5.9 The reliance placed by the counsel for appellant on the decision of this tribunal in case of Ram Decorative & Industries Limited [2000 (124) ELT 659 (T)] is not of any help. In that decision the tribunal was dealing with goods which are tangible in nature and were produced for sale to the customer on an agreed price. The charges which were collected towards the goods not actually lifted by the buyer were held not to be added to the value of the goods that were actually lifted by the buyer. In the case of services, which are intangible in nature the same principle cannot apply. The services are agreed to be provided against the consideration for providing them. The facility of foreclosure of loan was the service provided by the appellant to their client against the consideration which they called prepayment "levy charges". Since these charges were towards the allowing the facility for early exit to the client, they cannot be called the damages too. The reliance placed by the appellant on the various Commentaries in relation to Contract, referred in para 4.2 above do not help the case of the appellant. For levy of liquidated damages the existence of specific contract, whose performance has been vitiated by the actions of the parties to the contract

need to be established. In the present case appellants have not been able to establish existence of such a contract whereby borrower was prevented/ barred from early exit. On the contrary as option of early exit has been extended against payment of prepayment levy charges has been provided by the loan agreement/ contract itself. Thus we are not in position to agree with submissions of the appellant that these charges are in nature damages recovered from the customers. Since it was an option extended at the time of entering into the contract/ loan agreement, the same cannot also be termed as liquidated damages for non performance of the conditions specified in the contract. The contract specifies a charge levied for exercising the option the said charge cannot be penalty or liquidated damage to compensate the loss.

5.10 In view of discussions as above we do not find any merits in submissions of the Appellant, relying on the Hon'ble Apex Court decision in case of Intercontinental Consultants and Technocrats Pvt Ltd [2018 (10) GSTL 401 (SC)]. In this case there is clear nexus between the service provided and the consideration received. Since the option of early exit is part of the loan agreement it is essentially part and parcel of lending activities undertaken by the appellants. In case of HUDCO, Tribunal has held as follows:

"8. *This definition of 'Banking and other financial services' was amended by Finance Act, 2004 and the present definition as amended reads as under :*

"banking and financial services" means -

(a) the following services provided by a banking company or a financial institution including a non banking financial company or any other body corporate or commercial concern, namely :-

(i) financial leasing services including equipment leasing and hire purchase;

(ii) credit card services;

(iii) merchant banking services;

(iv) securities and foreign exchange (forex) broking;

(v) asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services, but does not include cash management;

(vi) advisory and other auxiliary financial services including investment and portfolio research and advice, advice on mergers and acquisitions and advice on corporate restructuring and strategy; and

(vii) provision and transfer of information and data processing; and

(viii) other financial services, namely, lending, issue of pay order, demand draft, cheque, letter of credit and bill of exchange, providing bank guarantee, overdraft facility, bill discounting facility, safe deposit locker, safe vaults, operation of bank accounts;

(b) foreign exchange broking provided by a foreign exchange broker other than those covered under sub-clause (a);

From the above, it can be seen that sub-clause (viii) and clause (b) marked bold were added in the 2004 Budget thus expanding the scope of services."

9. *A taxable service is defined under Section 55(105)(zm) of Finance Act, 1994 and is as under :*

"Taxable service means any service provided or to be provided to any person by a banking or a financial institution including non-banking financial company or any other body corporate or commercial concern, in relation to banking and other financial service."

10. *The definitions produced as above, would show that all the services related to lending form part of the taxable*

service. Therefore, the question is whether the prepayment charges and charges levied for resetting the interest rate form a part of the lending process or not. If the amounts collected are in the nature of interest, no Service Tax is leviable since there is no Service Tax on the interest, but only on the activity of lending. The appellants have contended that such charges are nothing but interest and are treated as interest. The question to our mind is not whether how the appellants are treating it or income tax department is treating it, but the question is whether the activity of collecting prepayment charges and reset charges in respect of a borrower can be called as service in relation to lending. When a borrower opts for prepayment of loan, as submitted by the appellants themselves, the tenure of the loan, reason for the prepayment, track record of the borrower in servicing loan, the Interest rate existing at the time of lending and at the time of closure, and the loss to the lender because of prepayment are taken into account. Admittedly, the prepayment charges vary from borrower to borrower, according to the appellant themselves. Further, it is collected for premature closure of the loan and it is not the interest factor that is taken into account. It has to be noted that when a borrower makes a prepayment and therefore pays interest separately up to the date of payment, that amount is shown separately as interest and prepayment charges are not collected as interest, but collected as prepayment charges. Further, even though the borrower has already borrowed the money and the process is over, when prepayment is proposed, borrower is expected to make a request which has to be considered by lender, charges worked out and informed and paid along with principal and interest up to the date of payment. Therefore, there is definitely an element of service involved in considering the request of the borrower for prepayment of loan, fixing of prepayment charges, collection of the same and closure of loan. These activities can be definitely in relation to Banking & other

Financial services, which includes lending after 10-9-04. Further, when loans are foreclosed, the situation gives rise to the issue of asset liability mis-match for the lender since lender has to find alternative source for deployment of such funds. Prepayment charges are the charges leviable by a bank/lender to offset the cost of such finding such alternative source for deployment of fund and also intended to make exit difficult for the borrower. This shows that prepayment charges can never be considered to be in the nature of interest.

11. *The appellants relied upon the judgment of Tribunal in the case of SIDBI, wherein the Tribunal had held that the activity of foreclosure of the loan cannot be treated as Banking & other Financial Service.*

12. *We have considered the decision of the Tribunal in the case of SIDBI. In that case, the demand for Service Tax was made on the amount collected for prepayment of direct loan from the customer. In that case also, as in the present case, it was submitted by the appellant that foreclosure of loan is a case of ending service and foreclosure charges are basically in lieu of interest loss and to prevent the customer from indiscriminately seeking foreclosure. While considering the issue, Tribunal took note of the definition of Banking & other Financial Services as existed prior to amendment only. After reproducing the definition, the Tribunal has observed that "the authorities below have not indicated as to which category of the definition, the activity of foreclosure falls under. Foreclosure is an ending of loan already given and cannot be treated as a service to the customer of loan and hence the same cannot be treated as rendering any services by the financial institution. We agree with the ld. Advocate that it is a case of withdrawing services rendered at the request of customer and the foreclosure premium is a kind of compensation for possible loss of expected revenue, on the loan amount returned by the customer. The most important aspect to be taken note of is the fact that during*

the relevant time, the services provided in relation to lending were not taxable. Therefore, the Tribunal had no occasion to consider whether the service was in relation to lending. The appellants contended that the Tribunal had considered the issue and come to the conclusion that the activity of foreclosure is amounting to withdrawal of the service and not providing any service at all and therefore, the decision of the Tribunal in the case of SIDBI would be still applicable even though the definition was different. At this stage, we have to take note of the fact that in the case of SIDBI, the Department had not even indicated as to which part of the definition, the activity of foreclosure falls under. The observations of the Tribunal in the order start with this sentence. There was no discussion as to the nature of payment, method adopted, how it is covered under the definition and why it is taxable. When the definition itself did not cover the lending activity itself, the question as to whether the prepayment of loan is a part of service or not, was not considered and could not have been considered. The observations of the Tribunal have to be considered in the context in which they were made and in line with which provisions they were made and it is also to be taken note that the decision is in the light of the submissions made by both sides. In this connection, we find it appropriate to take note of the decisions cited by the ld. Authorised representative appearing for the Department and listed below, to support his submission that the facts of the decision relied upon have to be shown, and the ratio of the case is what is decided therein in the facts of the case and not what logically can be deducted from the same.

(i) Collr. of CCE, Calcutta v. Alnoori Tobacco Products - 2004 (170) E.L.T. 135 (S.C.)

(ii) CCE, Bangalore v. Srikumar Agencies - 2009 (13) S.T.R. 3 (S.C.)

(iii) Sneh Enterprises v. CC, New Delhi - 2006 (202) E.L.T. 7 (S.C.)

13. *We find that these decisions support the submissions. We have already seen that in the case of SIDBI, the facts were not discussed in detail, statutory provisions were different and the submission were different.*

14. *The two decisions of the European Court cited by the ld. Counsel are not appropriate since they do not really relate to Banking & other Financial Services. Further without comparing statutory provisions, it will not be appropriate to rely upon the decision of the European Court, for Indian cases. The appellants also relied upon the decision of Hon'ble High Court of Madras in the case of Edupuganti Pitchayya & Ors v. Gonuguntla Venkata Ranga Row, dt. 20-10-43. In that case, Hon'ble High Court took a view that out of the amount collected over and above the principal is in the nature of interest and it denotes consideration of or otherwise in respect of loan or retention by one party of some of money or other property belonging to another. This was submitted to support the view that prepayment charges and reset charges are nothing but interest. In this case, prepayment/reset charges are not in the nature of interest at all but is in the nature of charge for early closure of loan/resetting of loan and is relatable to lending since it either closes the loan or charges the terms and hence it cannot be equated with interest at all. It has to be noted that in the case of prepayment, interest is collected separately till the date of prepayment. It is also not necessary that when a loan is prepaid or reset, the lender suffers. In fact, foreclosure by prepayment and reset are relatable to lending and if an application for processing a loan application is chargeable to Service Tax and processing fee charged for foreclosure/prepayment of loan or reset of interest would also be chargeable. In fact, we are unable to see what is the difference between the liability of Service Tax in respect of application of a loan where the processing fee is charged which is independent of loan and over and above the interest, when we see here also it is over and above*

the interest. The processing fee is charged for considering the various aspects such as credit worthiness of the borrower repaying capacity of the borrower, period of loan vis-à-vis repaying capacity of the borrower, quality of assets of the borrower etc. When the proposal is made for prepayment of loan or resetting, processing the application is involved. Therefore, there is definitely an element of service in prepayment of loan or resetting of interest. As already discussed earlier, the definition covers any activity in relation to lending.

15. *Even though, we have not discussed the charges levied for resetting the loan in detail, the principle underlining reset of interest and prepayment of loan are same. The Revenue has a better case in respect of reset charges since the issue is not at all covered by the decision of the Tribunal in the case of SIDBI as far as resetting charges are concerned. Further, in the case of resetting, the relationship between the lender and the borrower does not cease to exist and loan also continues. Therefore, resetting of interest rate can be definitely considered as a service rendered by the appellant in relation to lending and is covered by Service Tax definition. It was submitted by the appellant that resetting charges were not being collected by them after 2004-2005. However, it was submitted by the ld. A.R. appearing for the Department that in the financial year 2005-06, 2006-07, 2007-08, the appellant had changed the head of income from resetting charges to additional interest. We find that this submission was not made before the original adjudicating authority and further we also find that in Para 5 wherein the Service Tax liability has been worked out in the table, in the first year, it has been shown as reset charges whereas in the year 2005-06, it has been shown as additional interest charges. In the year 2006-07 and 2007-08, it has been specifically indicated as additional interest (prepayment). This gives an impression that contrary to the submission made by the ld. A.R. appearing for the Department, the*

Department's contention was that in the year after 2005-06, the appellant did not collect any reset charges. In any case, in view of the conclusion that we have reached that the service tax is payable on reset charges as well as prepayment charges, we consider that it is not necessary for us to go into this aspect.

16. *……..*

17.1 *The appellant has contended that Service Tax is a value added tax. Service Tax may be charged when there is a value addition in the services provided by the service provider. Since the customers do not get any value addition in the services provided by charging reset charges/prepayment charges, Service Tax is not payable.*

17.2 *Charges collected for restructuring of loans and prepayment of loans is a way of value addition. The very fact that the cost that the customer has to pay for the facilities of prepayment/reset, is named as prepayment "charge" and reset "charge", immediately conveys that the same is in the nature of fee in lieu of some service/facility. The cost of the service for the customers increases or decreases with the increase or decrease of these charges. Thus, the reset charges and prepayment charges can be considered as the cost incurred by the borrower towards value added services like restructuring of the loan and prepayment of loan. Hence, the same charges are liable for Service Tax.*

18.1 *Reset charges/prepayment charges charged to the customers by the appellant is in the nature of additional interest only and therefore not liable to Service Tax.*

18.2 *The appellant has contended that the said charges are calculated taking into consideration the rate of interest and loan amount. Thus, they are in the nature of additional interest and not liable to Service tax.*

18.3 *It has already been discussed that the prepayment charges are the charges for allowing the facility of prepayment of loan. Similarly, reset charges are the*

charges levied by the appellant for restructuring the interest rate. The method of calculating the charges has no bearing on the nature of service provided. Just because the charges have been calculated based on the outstanding loan amount and the interest rate prevalent at that time will not change the head of income from service charges to interest.

18.4 *Interest is nothing but the time-compensation for somebody's money being retained by somebody else. The longer the period of retention, the higher will be the interest amount. In this background, the prepayment charges can never be considered to be in the nature of interest as prepayment only means payment before time. This should ideally result in refund of interest and not the demand for more interest because the borrowed money is being paid back before time*."

5.11 Following the decision of HUDCO, tribunal has in case of Punjab National Bank, in respect of Commitment Charges held as follows:

"***5.*** *I have carefully gone through the facts of the case and submissions made by the appellants in the appeal memorandum and during personal hearing. I observe that the commitment charges are the charges imposed on the client who decide not to draw the amount of loan that has been at their disposal. These charges are basically to compensate for the loss of interest that the bank would have earned if the customer had drawn money from loan account. It is seen that the charges are related to lending of money to the client and; in order to give limit/overdraft facility, the bank keeps the fund available for the same. Under such circumstances, it is evident that such charges are integrally connected with the lending which is a taxable service. Therefore, commitment charges cannot be separated from lending service. I, therefore, hold that the commitment charges are chargeable to Service Tax and the amount of Rs. 46,902/- is recoverable from them."*

5.12 On the issue of limitation the only ground urged by the appellant is that was confusion prevailing in respect of levy of Service Tax in respect of the Commitment Charges, which lead to delay in payment of taxes. We do not find any merits in the submissions of the Appellant. Appellants have not shown any bonafide reason to show that they entertained such a belief. Further if they claim the issue was clarified by CBEC only in 2011, then what made them pay the service tax in the year 2006. The arguments advanced by the appellants do not establish the existence of such a bonafide belief. In case of HUDCO, the bench rejected the similar grounds raised by the appellant on limitation stating as follows:

"20. *It was submitted on behalf of the appellant that the appellant is wholly owned Government Company and therefore there cannot be mala fide intention on their part to evade payment of Service Tax. Revenue relied upon the decision of the Tribunal in the case of Bharat Petro Corporation Ltd. v. CCE, Nasik 2009 (242) E.L.T. 358 (Tri.-Mum.), wherein the Tribunal upheld the submission that BPCL is a Government owned company had suppressed the fact and therefore, just because it is wholly owned Govt. company, it cannot be said that bona fide can be presumed. He also submitted that blind belief cannot be a ground for non-payment of taxes. In this case, we find that the appellants have treated the amount of prepayment charges as additional interest and reset charges as additional interest from 2005-2006. It was also submitted that Income Tax Department has accepted such treatment given by them. The fact remains that after definition of lending was amended, and the service tax definition included in the activity in relation to lending for liability to Service Tax, appellant should have intimated the fact to the Department and checked up whether such collection of amount in relation to lending would be liable to tax or not. It is settled law that Government company is not Government and it has to be taken note that even*

Government departments make the payments for the services received from another department. Telecommunication department used to provide telecommunication services to other departments and other departments paid for the telecom services rendered and even for the services rendered by Railways, Postal and other departments, payments are made. Therefore, the fact that the appellant is a wholly owned government company, does not mean that they need not have to follow the law of land or take it lightly and plead ignorance of law or being a wholly government company, seek differential treatment. The fact remains that the appellant was required to declare the income received once the law was amended and they were required to seek clarification, if there was doubt. Even if they felt that the activity did not attract Service Tax, ST-3 returns should have been filed/or Department addressed intimating that these services are not liable to tax. In this case, the submission made by the ld. A.R. that plea of bona fide has to be considered in the light of decision of the Tribunal in the case of SPIE CAPAG S.A. v. CCE Mumbai - 2009 (243) E.L.T. 50 (Tri.-Mum.), is appropriate. In that case, while dealing with the plea of bona fide belief, the Tribunal observed that ‘‘the least that was expected of the appellant to discharge the plea of bona fide belief was to make enquiries from Central Excise authorities or some reputed legal firm regarding dutiability of items manufactured by it.” Therefore, we find ourselves in agreement with the submissions that the appellant could not have interpreted the law according to their understanding without taking sufficient care for their interpretation, is correct. In the absence of any evidence to show that the appellant had intimated the Department or had obtained legal opinion, invocation of extended period on the ground of suppression of facts has to be upheld.

21. *Therefore, the demand for extended period for Service Tax and interest thereon has to be upheld.”*

5.13 Thus following the decision as above we uphold the demand of Service Tax made by invoking the extended period of limitation. Also the demand made in respect of the interest at appropriate rate under Section 75 is upheld.

5.14 We also take note of the fact that appellants have in fact paid the entire amount of service tax (including cesses) and intimated to the department. Major portion of the taxes was paid within the stipulated time. The details of demands and payments made are summarized in the table below:

SCN Date	Period	Service Tax including Cess 'Rs			Remark
		Demanded	**Confirmed**	**Paid**	
07.10.08	2004-08	57519824	57519824	57519824	Letter/11.05.12
01.10.09	2008-09	24585014	24585014	24585014	Letter/21.11.12
01.09.10	2009-10	33900609	4871597	4871597	
			29029012	29029012	Paid regularly under protest as per SCN itself
11.08.11	2010-11	39100641	0	39100641	
26.09.12	2011-12	8859196	8859196	8859196	
Total		163965284	124864643	163965284	

5.15 On the issue of penalty Tribunal has in case of HUDCO held as follows:

"22. *An alternative submission was made that the provisions of Section 80 are invocable in this case. According to Section 80 of Finance Act, 1994, "provision of Section 76, 77 or 78, no penalty shall be imposable on the assessee for any failure referred to any such provision, if the assessee prove that there was a reasonable cause for the said failure." We consider that the appellant being a wholly owned government company and the fact that they did not pay Service Tax only on prepayment charges and reset charges and also in view of the fact that accounting treatment given to these items as additional interest has been accepted by the Income Tax department, in our opinion, would be sufficient for invoking provisions of Section 80 of Finance Act, 1994. Accordingly, while upholding the demand of Service Tax and interest,*

penalties imposed under various Sections of Finance Act, 1994 are set aside."

5.16 In our view when he have held the invocation of extended period of limitation in terms of proviso to section 73(1), penalty under Section 78 should follow in view of the decision of Hon'ble Apex Court in case of Rajasthan Spinning and Weaving Mills [2009 (238) ELT 3 (SC)]. Also for various contraventions of the provisions of Chapter V of Finance Act, 1994, the penalties imposed under Section 76 and 77 too are justified. We also take note of the Section 80 of The Finance Act, 1994 whereby the following has been provided:

"80. Notwithstanding anything contained in the provisions of Section 76, Section 77, Section 78 or Section 79 , no penalty shall be imposable on the assessee for any failure referred to in the said provisions, if the assessee proves that there was reasonable cause for the said failure."

Taking note of the fact that Appellants have deposited the entire amount of Service Tax and also the decisions in case Adecco Flexione Workforce {2012 (26) STR 3 (Kar)] wherein Hon'ble Karnataka High Court held as follows:

"3. *Unfortunately the assessing authority as well as the appellate authority seem to think. If an assessee does not pay the tax within the stipulated time and regularly pays tax after the due date with interest. It is something which is not pardonable in law. Though the law does not say so, authorities working under the law seem to think otherwise and thus they are wasting that valuable time in proceeding against persons who are paying service tax with interest promptly. They are paid salary to act in accordance with law and to initiate proceedings against defaulters who have not paid service tax and interest in spite of service of notice calling upon them to make payment and certainly not to harass and initiate proceedings against persons who are paying tax with interest for delayed payment. It is high time, the authorities will change their attitude towards*

these tax payers, understanding the object with which this enactment is passed and also keep in mind the express provision as contained in sub-sec. (3) of Sec. 73. The Parliament has expressly stated that against persons who have paid tax with interest, no notice shall be served. If notices are issued contrary to the said Section, the person to be punished is the person who has issued notice and not the person to whom it is issued. We take that, in ignorance of law, the authorities are indulging in the extravaganza and wasting their precious time and also the time of the Tribunal and this Court. It is high time that the authorities shall issue appropriate directions to see that such tax payers are not harassed. If such instances are noticed by this Court hereafter, certainly it will be a case for taking proper action against those law breakers."

Similar view has been taken in case of Master Kleen [2012 (25) STR 439 (Kar)] and Tide Water Shipping Pvt Ltd [2015 (37) STR 558 (T-Bang)]. Thus we find the case to be fit where provisions of Section 80 should be invoked to set aside the penalties that are imposed under Section 76, 77 & 78 of Finance Act, 1994.

6.1 In view of above we-

I. allow appeal No ST/347/2012 to the extent of setting aside the penalties imposed under Section 76, 77 and 78 of Finance Act, 1994. The impugned orders to the extent of confirming the demand of Service Tax and interest is upheld. Amounts paid are appropriated against the demand of service tax confirmed against the appellant.

II. dismiss the department appeal No ST/88057/2013 to the extent of seeking to impose penalties on the appellant. We allow the appeal of the department to the extent of upholding that prepayment charges are subjected to levy of service tax and appropriate the amounts paid by the appellants towards the demand of service tax made.

III. dismiss the appeal No ST/87781/2013 filed by the party and appropriate the amounts paid by the appellant for the period of dispute against the demands confirmed.

IV. dismiss the appeal No ST/87431/2013 filed by the party.

(Order pronounced in the open court on 21.08.2019)

(S.K. Mohanty)
Member (Judicial)

(Sanjiv Srivastava)
Member (Technical)

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