

**THE AUTHORITY FOR ADVANCE RULING
IN KARNATAKA
GOODS AND SERVICES TAX
VANIJYA THERIGE KARYALAYA, KALIDASA ROAD
GANDHINAGAR, BENGALURU - 560 009**

Advance Ruling No. KAR ADRG 33 / 2023

Dated: 16.11.2023

Present:

1. Dr. M.P. Ravi Prasad
Additional Commissioner of Commercial Taxes Member (State)
2. Sri Kiran Reddy T
Additional Commissioner of Customs & Indirect Taxes Member (Central)

1.	Name and address of the applicant	M/s. Enzyme Business Center, Plot 1546 & 1547, 19 th Main Road, HSR Layout, Bengaluru-560 102.
2.	GSTIN or User ID	29AADFE1798C2ZD
3.	Date of filing of Form GST ARA-01	23-05-2023
4.	Represented by	Sri Gella Praveen Kumar, Chartered Accountant
5.	Jurisdictional Authority - Centre	The Principal Commissioner of Central Tax, Bengaluru South GST Commissionerate, South Division-5, RANGE-ASD5
6.	Jurisdictional Authority - State	ACCT, LGSTO-016, Bengaluru
7.	Whether the payment of fees discharged and if yes, the amount and CIN	Yes, discharged fee of Rs.5,000-00 under CGST Act and Rs.5,000-00 under SGST Act vide debit of Electronic Cash Ledger Reference No.DC2905230029784 Dated 06.05.2023

**ORDER UNDER SECTION 98(4) OF THE CGST ACT, 2017
& UNDER SECTION 98(4) OF THE KGST ACT, 2017**

M/s. Enzyme Business Center, Plot 1546 & 1547, 19th Main Road, HSR Layout, Bengaluru-560 102 (hereinafter referred to as 'The applicant'), having GSTIN 29AADFE1798C2ZD have filed an application for Advance Ruling under Section 97 of CGST Act, 2017 read with Rule 104 of CGST Rules, 2017 and Section 97 of KGST Act, 2017 read with Rule 104 of KGST Rules, 2017, in FORM GST ARA-01 discharging the fee of Rs.5,000/- each under the CGST Act and the KGST Act.



M/s. Enzyme Business Center

2. The applicant is a Partnership firm registered under the provisions of Central Goods and Services Tax Act, 2017 as well as Karnataka Goods and Services Tax Act, 2017 (hereinafter referred to as the CGST Act and KGST/SGST Act respectively). The applicant is engaged into sub-letting of commercial property on rental basis.

3. The applicant has sought advance ruling in respect of the following questions:

- i. *Whether damages received by the applicant amounting to Rs.1,85,00,000/- from the tenant towards the termination of sub-lease before the agreed upon lock-in period as per the sub-lease deed agreements dated 3rd November 2021 and 11th January 2022 tantamount to supply as per Section 7 of Central GST Act, 2017 and will the amount received towards damages for Rs.1,85,00,000/- as per the settlement agreement dtd: 18-04-2023 to be construed as Consideration for the above supply?*
- ii. *If answer to the above question is affirmative, what is the Rate of GST applicable and what shall be appropriate classification / SAC for payment of GST?*

4. Admissibility of the application: The question is about the “Classification of any goods or services or both”, “determination of the liability to pay tax on any goods or service or both” and “whether any particular thing done by the applicant with respect to any goods and / or services or both amounts to or results in a supply of goods and/or services or both, within the meaning of that term” is admissible under Section 97(2)(a) 97(2)(e) and 97(2)(g) of the CGST Act 2017.

5. Brief Facts of the Case:

- 5.1 The applicant states that they have entered into lease agreement with two different landlords and has obtained two premises for lease.
- 5.2 The applicant states that they have sub let the above two premises to M/s Novocura Tech Health Services Pvt. Ltd., [hereinafter referred as **Client**] vide agreement dated 3rd November 2021 and 11th January 2022;
- 5.3 The Applicant states that their client approached them stating their incapability to continue the above mentioned agreements/contract; that to maintain cordial relationship with the client, they agreed upon for the early termination of the contract subject to payment of damages by the Client.
- 5.4 The applicant states that they have received the amount towards damages by way of forfeiture of interest free security deposit of Rs.1,19,00,000/- and Rs.16,00,000/-. The Client has also paid Rs.50,00,000 from Jul'22 to Jan'23 in various trenches towards damages for foreclosure as one-time settlement.

6. Applicant's Interpretation of Law:

- 6.1 The applicant states that sub-section (1A) of Section 7 states that certain activities or transactions will be considered as a supply of goods or services, if it is a supply of



goods or services and in exchange for a consideration and is a business transaction. To examine the classification as goods or services, first and foremost the transaction should satisfy the requirements of Supply as per provisions of Section 7(1) of Central Goods and Services Tax Act, 2017

6.2 The applicant is of the view that this is not a deemed service. Entry No 5(e) in Schedule II of the CGST Act 2017 states that the following activity is to be treated as a deemed supply - "Agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act" There are 3 legs to this definition:

- i. Agreeing to the obligation to refrain from an act
- ii. Agreeing to the obligation to tolerate an act or situation
- iii. Agreeing to the obligation to do an act

This definition draws a parallel to the definition of contract as per The Indian Contract Act, 1872. Section 2(h) of the Contract Act defines a Contract as "An agreement which is enforceable by Law". There has to be an agreement which is legally valid and consisting a set of promises in exchange for a consideration. The applicant contends that **providing working space** as per the rental agreement is the **principal essence of the contract** to supply. In the event of failure to continue with the supply/ terminate the contract prior to the agreed upon lock-in period, the lessee makes the payment of damages for the contract violation as per the agreement duly agreed upon and the same is not considered as a Supply.

6.3 The applicant states that the breach of lock-in period is a breach of contract and Section 73 of the Indian Contract Act, 1872 deals with compensation for loss or damage caused by breach of contract. Further, the Section states that the injured party is entitled to receive the same amount of compensation quantified in money terms as he would be entitled to receive if the breach had not happened.

6.4 The applicant is of the understanding that the amount received and the amount forfeited are in the nature of liquidated damages for loss of rent and is in the nature of compensation for violation of the lock in period clause in the agreement.

6.5 The applicant is of the view that Circular No 178/10/2022 is squarely applicable in this case as the lock-in clause arises out of the primary rental contract and is only a compensatory clause.

As per Circular No 178/10/2022, "A reasonable view that can be taken with regard to taxability of liquidated damages is that where the amount paid as 'liquidated damages' is an amount paid only to compensate for injury, loss or damage suffered by the aggrieved party due to breach of the contract and there is no agreement, express or implied, by the aggrieved party receiving the liquidated damages, to refrain from or tolerate an act or to do anything for the party paying the liquidated damages, in such cases liquidated damages are mere a flow of money from the party who causes breach of the contract to the party who suffers loss or damage due to such breach. Such payments do not constitute consideration for a supply and are not taxable."



Hence, it is very clear that damages are monetary compensation for loss due to non-occupancy of the rental property and no GST is applicable in this regard.

PERSONAL HEARING / PROCEEDINGS HELD ON 13.07.2023

7. Sri Gella Praveen Kumar, Chartered Accountant and Duly Authorised Representative appeared for personal hearing proceedings held on 13.07.2023 and reiterated the facts narrated in their application.

FINDINGS & DISCUSSION

8. At the outset we would like to make it clear that the provisions of CGST Act, 2017 and the KGST Act, 2017 are in pari-materia and have the same provisions in like matter and differ from each other only on a few specific provisions. Therefore, unless a mention is particularly made to such dissimilar provisions, a reference to the CGST Act would also mean reference to the corresponding similar provisions in the KGST Act.

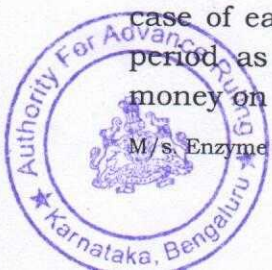
9. We have considered the submissions made by the applicant in their application for advance ruling. We have also considered the issues involved on which advance ruling is sought by the applicant and the relevant facts along with the arguments made by their authorized representative and also their submissions made during the time of hearing.

10. The applicant is engaged in sub-letting of commercial property on rental basis. The applicant states that they have obtained two premises for lease and has sub-let them to M/s Novocura Tech Health Services Pvt. Ltd., (hereinafter referred as **Client**). Due to their incapability to continue the above-mentioned sub-let contracts, M/s Novocura Tech Health Services Pvt. Ltd has made payment of damages to the Applicant for the early termination of the contract. The Applicant states that payment of damages is for the contract violation as per the agreement duly agreed upon and the same is not considered as a Supply under GST.

11. Now let us examine whether damages received by the Applicant is for a supply or not. On going through the sub lease agreements signed between the Applicant and their client, it is observed that there is a clause which says as below:

3. ----- in the event of early termination the LESSEE shall continue to be liable for the rental that would otherwise be payable for the reminder of the lock-in period, the LESSOR shall refund the security deposit to the LESSEE within 30 days of such termination.

12. The amount which was received by the applicant from their client, was a part of the terms and condition of the lease agreement signed between the applicant and their client. This means that, while entering into the agreement, the client was aware about the terms and conditions of the contract that, in case of breach of agreement, i.e, in case of early termination, they shall be liable to pay the rental till the end of lock-in period as a settlement for exit from the contract. Thus the Applicant has received money on account of non fulfillment of conditions as stipulated in the lease agreement.



13. Now let discuss whether above mentioned act by the Applicant is covered under the scope of supply under section 7 CGST Act, the same of which is reproduced below:

Section 7. Scope of supply.-

(1) For the purposes of this Act, the expression - "supply" includes-

(a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;

(aa) the activities or transactions, by a person, other than an individual, to its members or constituents or vice-versa, for cash, deferred payment or other valuable consideration.

Explanation .-For the purposes of this clause, it is hereby clarified that, notwithstanding anything contained in any other law for the time being in force or any judgment, decree or order of any Court, tribunal or authority, the person and its members or constituents shall be deemed to be two separate persons and the supply of activities or transactions inter se shall be deemed to take place from one such person to another;]

(b) import of services for a consideration whether or not in the course or furtherance of business; ²[and]

(c) the activities specified in Schedule I, made or agreed to be made without a consideration;

(1A) where certain activities or transactions constitute a supply in accordance with the provisions of sub-section (1), they shall be treated either as supply of goods or supply of services as referred to in Schedule II.]

(2)

(3)

SCHEDULE II.

ACTIVITIES OR TRANSACTIONS TO BE TREATED AS SUPPLY OF GOODS OR SUPPLY OF SERVICES

1.

2.

(3)

(4)

5. Supply of services

The following shall be treated as supply of services, namely:-

(a) renting of immovable property;



(b) construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or after its first occupation, whichever is earlier.

Explanation. -For the purposes of this clause-

(1) the expression "competent authority" means the Government or any authority authorised to issue completion certificate under any law for the time being in force and in case of non-requirement of such certificate from such authority, from any of the following, namely:-

(i) an architect registered with the Council of Architecture constituted under the Architects Act, 1972 (20 of 1972); or

(ii) a chartered engineer registered with the Institution of Engineers (India); or

(iii) a licensed surveyor of the respective local body of the city or town or village or development or planning authority;

(2) the expression "construction" includes additions, alterations, replacements or remodelling of any existing civil structure;

(c) temporary transfer or permitting the use or enjoyment of any intellectual property right;

(d) development, design, programming, customization, adaptation, upgradation, enhancement, implementation of information technology software;

(e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act; and

(f) transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.

13.1 In the impugned case, the Applicant has refrained from taking subsequent action/ tolerated an act of the client, for which consideration has been received by him. The payment of amount is for an act of tolerance in the sense that, when there is breach of the contract, the other party is put to certain hardships, which he tolerates in return of the payment received by his client. The same can be understood as consideration received by the Applicant for "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation" of their client of not completing the lock-in period, which he had agreed in terms of contractual obligations.

13.2 As per the contract, the Applicant agrees to refrain or tolerate or to do an act. In case obligation/condition of the contract is not fulfilled, then such act is squarely covered under clause 5(e) of Schedule-II. Therefore, this activity constitutes supply in terms of Section 7(1) of CGST Act, 2017.



14. The Applicant has relied upon CBIC circular No.178/10/2022 stating that damages are monetary compensation loss due to non-occupancy of the rental property and no GST is applicable in this regard. The circular explains about liquidated damages in para 7.1 to 7.1.6 and the same is reproduced below:

Liquidated Damages

7.1 Breach or non-performance of contract by one party results in loss and damages to the other party. Therefore, the law provides in Section 73 of the Contract Act, 1972 that when a contract has been broken, the party which suffers by such breach is entitled to receive from the other party compensation for any loss or damage caused to him by such breach. The compensation is not by way of consideration for any other independent activity; it is just an event in the course of performance of that contract.

7.1.1 It is common for the parties entering into a contract, to specify in the contract itself, the compensation that would be payable in the event of the breach of the contract. Such compensation specified in a written contract for breach of non-performance of the contract or parties of the contract is referred to as liquidated damages. Black's Law Dictionary defines 'Liquidated Damages' as cash compensation agreed to by a signed, written contract for breach of contract, payable to the aggrieved party.

7.1.2 Section 74 of the Contract Act, 1972 provides that when a contract is broken, if a sum has been named or a penalty stipulated in the contract as the amount or penalty to be paid in case of breach, the aggrieved party shall be entitled to receive reasonable compensation not exceeding the amount so named or the penalty so stipulated.

7.1.3 It is argued that performance is the essence of a contract. 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. Payment of liquidated damages is stipulated in a contract to ensure performance and to deter non-performance, unsatisfactory performance or delayed performance. Liquidated damages are a measure of loss and damage that the parties agree would arise due to breach of contract. They do not act as a remedy for the breach of contract. They do not restitute the aggrieved person. It is further argued that a contract is entered into for execution and not for its breach. The liquidated damages or penalty are not the desired outcome of the contract. By accepting the liquidated damages, the party aggrieved by breach of contract cannot be said to have permitted or tolerated the deviation or non-fulfilment of the promise by the other party.

7.1.4 In this background a reasonable view that can be taken with regard to taxability of liquidated damages is that where the amount paid as 'liquidated damages' is an amount paid only to compensate for injury, loss or damage suffered by the aggrieved party due to breach of the contract and there is no agreement, express or implied, by the aggrieved party



receiving the liquidated damages, to refrain from or tolerate an act or to do anything for the party paying the liquidated damages, in such cases liquidated damages are mere a flow of money from the party who causes breach of the contract to the party who suffers loss or damage due to such breach. Such payments do not constitute consideration for a supply and are not taxable.

7.1.5 Examples of such cases are damages resulting from damage to property, negligence, piracy, unauthorized use of trade name, copyright, etc. Other examples that may be covered here are the penalty stipulated in a contract for delayed construction of houses. It is a penalty paid by the builder to the buyers to compensate them for the loss that they suffer due to such delayed construction and not for getting anything in return from the buyers. Similarly, forfeiture of earnest money by a seller in case of breach of 'an agreement to sell' an immovable property by the buyer or 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. Forfeiture of Earnest money is stipulated in such cases not as a consideration for tolerating the breach of contract but as a compensation for the losses suffered and as a penalty for discouraging the non-serious buyers or bidders. Such payments being merely flow of money are not a consideration for any supply and are not taxable. The key in such cases is to consider whether the impugned payments constitute consideration for another independent contract envisaging tolerating an act or situation or refraining from doing any act or situation or simply doing an act. If the answer is yes, then it constitutes a 'supply' within the meaning of the Act, otherwise it is not a "supply".

7.1.6 If a payment constitutes a consideration for a supply, then it is taxable irrespective of by what name it is called; it must be remembered that a "consideration" cannot be considered de hors an agreement/contract between two persons wherein one person does something for another and that other pays the first in return. If the payment is merely an event in the course of the performance of the agreement and it does not represent the 'object', as such, of the contract then it cannot be considered 'consideration'. For example, a contract may provide that payment by the recipient of goods or services shall be made before a certain date and failure to make payment by the due date shall attract late fee or penalty. A contract for transport of passengers may stipulate that the ticket amount shall be partly or wholly forfeited if the passenger does not show up. A contract for package tour may stipulate forfeiture of security deposit in the event of cancellation of tour by the customer. Similarly, a contract for lease of movable or immovable property may stipulate that the lessee shall not terminate the lease before a certain period and if he does so he will have to pay certain amount as early termination fee or penalty. Some banks similarly charge pre-payment penalty if the borrower wishes to repay the loan before the maturity of the loan period. Such 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. Since these supplies are ancillary to the principal supply for which the contract is signed, they shall be eligible to be assessed as the principal supply, as discussed in detail in the later paragraphs. Naturally, such payments will not be taxable if the principal supply is exempt.

14.1 In para 7.1.6 of the circular, it is mentioned that amounts paid for early termination of lease as contemplated by the contract as part of commercial terms agreed to by the parties, constitute consideration for the supply of a facility, namely, early termination of a lease agreement. 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. Since these supplies are ancillary to the principal supply for which the contract is signed, they shall be eligible to be assessed as the principal supply.

14.2 From the above mentioned para of the circular, it is clear that amount paid for termination of lease constitute consideration for the supply of a facility and are subject to GST and they shall be eligible to be assessed as the principal supply. In the impugned case the principal supply is sub letting of a commercial property which is a taxable supply of service as explained supra and is classified under chapter heading 9972 – Real Estate Services. The same is taxable as per entry No.16(iii) of Notification No. 11/2017-Central Tax (Rate) dated 26.06.2017, as amended further which is reproduced below:

Sl. No.	Chapter, Section or Heading, Group or Service Code (Tariff)	Description of Service	Rate (percent)	Condition
16	Heading 9972	(i) Services by the Central Government, State Government, Union territory or local authority to governmental authority or government entity, by way of lease of land.	NIL	-
		(ii) Supply of land or undivided share of land by way of lease or sub lease where such supply is a part of composite supply of construction of flats, etc. specified in the entry in column (3), against serial number 3, at item [(i), (ia), (ib), (ic), (id), (ie) and (if)].	NIL	-
		Provided that nothing contained in this entry shall apply to an amount charged for such lease and sub-lease in excess of one third of the total		

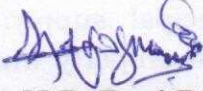


	amount charged for the said composite supply. Total amount shall have the same meaning for the purpose of this proviso as given in paragraph 2 of this notification.		
	(iii) Real estate services other than (i) and (ii) above.	9	-

15. In view of the foregoing, we pass the following

RULING

- i. The damages received by the applicant from the tenant towards the termination of sub-lease before the agreed upon lock-in period as per the sub-lease deed agreements tantamount to supply as per Section 7 of Central GST Act, 2017 and the amount received towards damages as per the settlement agreement is to be construed as Consideration for the above supply.
- ii. The services provided by the Applicant are classifiable under Chapter heading 9972 and is liable to GST at 18% (9% CGST and 9% SGST).

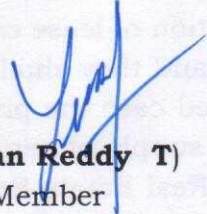

(Dr. M.P. Ravi Prasad)

Member

MEMBER

Karnataka Advance Ruling Authority

Place: Bengaluru - 560 009


(Kiran Reddy T)

Member

MEMBER

Karnataka Advance Ruling Authority

Bengaluru - 560 009

Date: 16.11.2023

To,
The Applicant

Copy to:

1. The Principal Chief Commissioner of Central Tax, Bangalore Zone, Karnataka.
2. The Commissioner of Commercial Taxes, Karnataka, Bengaluru.
3. The Principal Commissioner of Central Tax, Bengaluru South Commissionerate, Bengaluru.
4. The Assistant Commissioner of Commercial Taxes, LGSTO-016, Bengaluru.
5. Office Folder.

