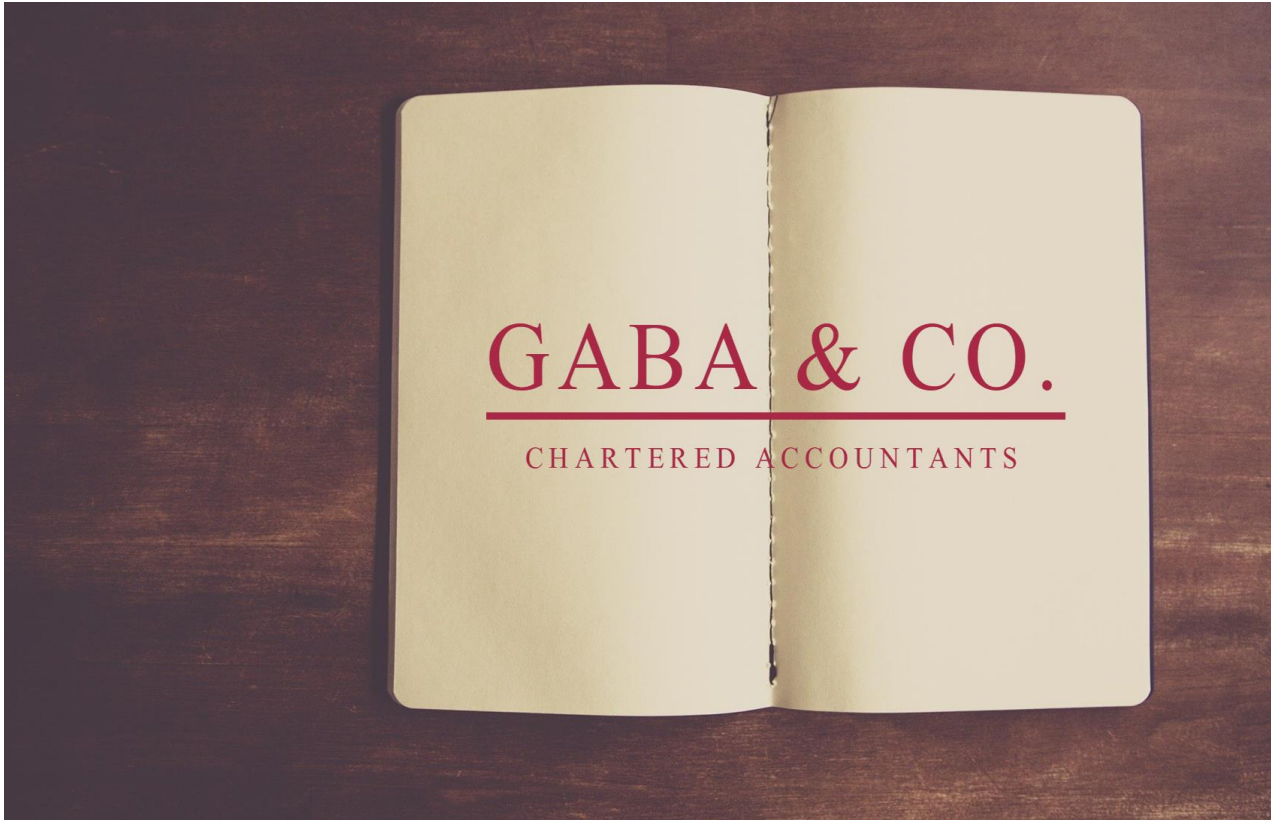


# Foreclosure Charges are not Liable to Service Tax

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This is to apprise you about one of the most important recent judgment by the Larger Bench of Tribunal in the case of ***CST v. Repco Home Finance Limited (Order No. 40053/2020)***. The Tribunal was dealing with the taxability of foreclosure charges collected by the taxpayer.

## A. FACTS

- The taxpayer was dealing in providing home loans to the borrowers. One of the stipulations of the loan agreement was that in case a borrower wishes to prepay the entire loan amount, he would have to pay a certain percentage of principal amount as damages to the taxpayer. These damages were named as 'foreclosure charges'.
- Earlier, there were conflicting decisions by the Ahmedabad Tribunal (against) and Kolkata Tribunal (favour) for taxability of these charges. Hence, the matter went to the larger bench to decide upon the Service Tax ('ST') liability on the said foreclosure charges.

**B. FINDINGS & DECISION**

- The Tribunal observed that the premature termination of a loan results in loss of future interest income to the taxpayer and foreclosure charges are a compensation towards such loss/damage. It was held that damages cannot amount to 'consideration' under the ST laws.
- Referring to Indian Contract Act, 1872, it was also observed that where the consideration is not at the desire of the promisor, it ceases to be a consideration. Since, premature termination of a loan is a unilateral act on the part of the borrower, foreclosure charges cannot be treated as consideration at the desire of the taxpayer (loan provider).
- Most importantly, it was observed that the foreclosure charges should not be viewed as an '*alternative mode of performance*' of the contract because it stills contemplates performance whereas foreclosure is an express repudiation of specified terms of contract.

**C. GABA & CO. | REMARKS**

- *In our view, the Larger Bench decision is correct and supported not only by the Indian jurisprudence but by the international jurisprudence as well.*
- *The decision will equally apply to liquidated damages, cancellation fees/charges, penal charges etc.*
- *Further, in our view, the decision holds good under the Goods and Services Tax regime as well.*

**Disclaimer:**

*The views expressed in the update are strictly personal, based on our understanding of the underlying law. We are not responsible for any injury, loss or cost arising to any person who refers this update and acts or refrains from any act accordingly. We would suggest that a detailed legal advice must be sought before relying on this update.*