

### ***Maharashtra AAR holds that penal interest for delay in repayment of EMI attracts GST***

#### **Facts**

The applicant, a non-banking financial company, was *inter alia* engaged in providing loans. The loans were repayable by way of equated monthly instalments (EMI) through cheques/ ECS, etc. On dishonour of cheques/ ECS, etc. the applicant collects penal/ default interest for the delay committed by the customer. The applicant contended that such interest amount is exempt by virtue of Sr. No. 27 of Notification No. 12/ 2017-Central Tax (Rate), which exempts services by way of extending loans in so far as the consideration is represented by way of interest. Also, the penal interest collected from the customer is in the nature of additional interest on a new loan (i.e. defaulted EMI), and not subject to GST. Further, it can not be treated as a payment for toleration of an act of delay in payment by the customer.

#### **AAR's observations**

The Authority for Advance Ruling (AAR) held<sup>1</sup> that the penal charges/ interest amount to consideration for tolerating an act of delay in payment by the customer and would be subject to GST, on the following grounds:

1. The applicant's submission that a defaulted EMI is nothing but a new loan amount is fallacious, since the rate of interest on a loan advanced and the rate at which penal charges are collected on the so-called new loan are different.
2. The receipt of penal charges on delayed payment of EMIs would be a receipt of an amount on account of for tolerating the act of customers for delaying on their EMI payments beyond due dates. It is not additional interest.
3. The penal charges are recovered by the lender-applicant on account of tolerating the delay in payment by borrower. This amounts to 'supply'.
4. Exemption for financial transactions under GST laws is only in respect of the interest/ discount earned or paid for loans, deposits or advances. If the transaction deviates from the test of being a 'loan', 'deposit' or 'advance' or the consideration is not an interest or discount, the exemption is not admissible. In the present case, the penal charges can not be said to form a part of interest on 'loan', 'deposit' or 'advance'.

#### **PwC Comments**

This ruling adopts a position that appears contrary to the approach adopted historically by the financial services industry as no differentiation between 'general' and 'penal' interest from an indirect tax perspective has been adopted. While the ruling is binding only on the applicant and its jurisdictional officers (subject to appeal), this creates another area of potential dispute and the industry may need to represent this issue to the CBIC.

<sup>1</sup>GST - ARA, Application no. 22 dated 9 May, 2018

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With Best Regards  
PwC TRS Team

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