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Settlement of Arbitral Award and Withdrawal of Enforcement Proceedings Do Not Constitute 'Supply' Under GST

The Hon'ble Bombay High Court in the case of ***Tata Sons Private Ltd. v. Union of India & Ors.*** [Writ Petition No. 4914 of 2022, order dated April 30, 2026] held that settlement of a foreign arbitral award and withdrawal/suspension of enforcement proceedings by the award-holder pursuant to such settlement does not amount to a "supply" under Section 7 of the CGST Act read with Entry 5(e) of Schedule II. The Court quashed the DRC-01A intimation and Show Cause Notice seeking to levy IGST of ₹1,524.35 crore on damages paid by Tata Sons to NTT Docomo, holding that there was no independent agreement involving consideration for tolerating an act or refraining from an act.

Facts:

Tata Sons Private Ltd. (**"the Petitioner"**) is the principal investment holding company of the Tata Group. NTT Docomo Inc., a Japanese company, had invested in Tata Teleservices Limited ("TTSL") pursuant to a Shareholders Agreement dated March 25, 2009. Disputes arose when TTSL failed to achieve contractual performance benchmarks, resulting in arbitration before the London Court of International Arbitration ("LCIA"). The arbitral tribunal awarded damages, interest, legal costs and arbitration costs in favour of Docomo. The award was subsequently declared enforceable by the Delhi High Court on April 28, 2017.

Union of India through the Ministry of Finance, Central Board of Indirect Taxes & Customs (CBIC), Directorate General of GST Intelligence (**"the Respondents"**) initiated investigation and thereafter issued Form DRC-01A dated September 28, 2022 and Show Cause Notice dated July 26, 2023 proposing levy of IGST of ₹1,524.35 crore. The Respondents alleged that Docomo had tolerated Tata's breach of the Shareholders Agreement and agreed to refrain from pursuing enforcement proceedings in the UK and USA, thereby supplying a service under Entry 5(e) of Schedule II to the CGST Act.

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The Petitioner contended that the amounts paid to Docomo represented damages awarded under an arbitral award and enforced as a decree of court. Such damages were compensation for breach of contract and not consideration for any independent agreement to tolerate an act or refrain from an act. The Petitioner further relied upon CBIC Circular No. 178/10/2022-GST dated August 3, 2022 and Circular No. 214/1/2023-Service Tax dated February 28, 2023, which clarified that damages for breach of contract are not taxable in the absence of an independent agreement involving consideration.

Aggrieved by the DRC-01A intimation and the subsequent Show Cause Notice issued under Section 74(1) of the CGST Act, the Petitioner approached the Bombay High Court by way of a writ petition under Article 226 of the Constitution seeking quashing of both proceedings.

Issue:

Whether settlement of a foreign arbitral award and withdrawal/suspension of enforcement proceedings by the award-holder pursuant to such settlement constitutes “supply” under Section 7(1) of the CGST Act read with Entry 5(e) of Schedule II, thereby attracting levy of IGST?

Held:

The Hon’ble Bombay High Court in **Writ Petition No. 4914 of 2022** held as under:

- Observed that, Entry 5(e) of Schedule II contemplates an independent agreement whereby a party agrees, for consideration, to refrain from an act, tolerate an act or situation, or do an act. Such provision cannot be read divorced from Section 7 of the CGST Act, which requires a supply for consideration.
- Observed that, the consent terms entered before the Delhi High Court were intrinsically connected with enforcement and satisfaction of the arbitral award. They did not create any independent contractual rights or obligations dehors the arbitral award.

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- Noted that, withdrawal or suspension of enforcement proceedings in the UK and USA was merely a legal consequence of satisfaction of the arbitral award. Such proceedings were collateral and incidental to enforcement of the award and could not be treated as an independent supply of service.
- Observed that, there was no separate consideration paid by Tata to Docomo for refraining from pursuing enforcement proceedings. The amount paid was solely towards discharge of the arbitral award of damages.
- Noted that, the legal character of the amount received by Docomo was compensation for breach of contract. Damages awarded by an arbitral tribunal are not consideration for any service but are compensation flowing from adjudication of liability.
- Observed that, acceptance of the Revenue's position would mean that settlement of every money decree and withdrawal of execution proceedings would become taxable as supply of services, a result wholly unsupported by law.
- Noted that, CBIC Circular No. 178/10/2022-GST dated August 3, 2022 expressly clarifies that damages paid to compensate for injury, loss or damage due to breach of contract are not consideration for a supply and are not taxable unless there exists an independent agreement for toleration or forbearance.
- Observed that, the position accepted by CBIC in relation to liquidated damages equally applies to damages awarded under Section 73 of the Indian Contract Act, 1872. Both represent compensation for breach of contract and not consideration for a supply.
- Held that, the settlement before the Delhi High Court did not amount to "supply" under Section 7 of the CGST Act and therefore no liability under the CGST Act or IGST Act arose.
- Held that, the Designated Officer lacked jurisdiction to issue the impugned Show Cause Notice and the case fell within the exception to the rule of alternate remedy. Accordingly,

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the Court quashed the DRC-01A Intimation dated September 28, 2022 and the Show Cause Notice dated July 26, 2023 and allowed the writ petition.

Our Comments:

The Court's reasoning is founded upon the distinction between compensation for breach of contract and consideration for a taxable supply. The judgment extensively relies on CBIC Circular No. 178/10/2022-GST dated August 3, 2022 and Circular No. 214/1/2023-Service Tax dated February 28, 2023, both of which clarify that damages paid merely to compensate for breach do not constitute consideration for supply unless there exists an independent agreement to tolerate an act or refrain from an act.

The Supreme Court decision in ***Iron & Hardware (India) Co. v. Firm Shamlal & Bros.*[(1974) 2 SCC 231]** held that damages do not arise from an existing pecuniary obligation but become payable only by virtue of adjudication by a court or tribunal. The reasoning is that no pecuniary liability arises till the Court has determined that the party complaining of the breach is entitled to damages. Therefore, when damages are assessed, it would not be true to say that what the Court is doing is ascertaining a pecuniary liability which already existed. The Court in the first place must decide that the defendant is liable and then it proceeds to assess what that liability is. But till that determination there is no liability at all upon the defendant.

In ***South Eastern Coalfields Ltd. v. Commissioner of Central Excise and Service Tax, Raipur*[2020 (12) TMI 912]**, wherein High Court of Chattisgarh held that liquidated damages, forfeiture of earnest money and similar compensatory payments do not amount to consideration for tolerating an act under Section 66E(e) of the Finance Act, 1994. CBIC subsequently accepted this position and withdrew appeals before the Supreme Court, which the Court treated as reinforcing the non-taxability of compensatory damages.

Relevant Provisions:

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Section 7(1) of the CGST Act, 2017

“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; and

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

Entry 5(e), Schedule II of the CGST Act, 2017

5. Supply of services

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

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

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CBIC Circular No. 178/10/2022-GST dated August 3, 2022

“Subject: GST applicability on liquidated damages, compensation and penalty arising out of breach of contract or other provisions of law – reg.

2. “Agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act” has been specifically declared to be a supply of service in para 5 (e) of Schedule II of CGST Act if the same constitutes a “supply” within the meaning of the Act. The said expression has following three limbs: -

a. Agreeing to the obligation to refrain from an act-

Example of activities that would be covered by this part of the expression would include non-compete agreements, where one party agrees not to compete with the other party in a product, service or geographical area against a consideration paid by the other party.

Another example of such activities would be a builder refraining from constructing more than a certain number of floors, even though permitted to do so by the municipal authorities, against a compensation paid by the neighbouring housing project, which wants to protect its sunlight, or an industrial unit refraining from manufacturing activity during certain hours against an agreed compensation paid by a neighbouring school, which wants to avoid noise during those hours.

b. Agreeing to the obligation to tolerate an act or a situation.-

This would include activities such a shopkeeper allowing a hawker to operate from the common pavement in front of his shop against a monthly payment by the hawker, or an RWA tolerating the use of loud speakers for early morning prayers by a school located in the colony subject to the school paying an agreed sum to the RWA as compensation.

c. Agreeing to the obligation to do an act.-

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This would include the case where an industrial unit agrees to install equipment for zero emission/discharge at the behest of the RWA of a neighbouring residential complex against a consideration paid by such RWA, even though the emission/discharge from the industrial unit was within permissible limits and there was no legal obligation upon the individual unit to do so.”

CBIC Circular No. 214/1/2023-Service Tax dated February 28, 2023

“6. In view of above, it is clarified that the activities contemplated under section 66E(e), i.e. when one party agrees to refrain from an act, or to tolerate an act or a situation, or to do an act, are the activities where the agreement specifically refers to such an activity and there is a flow of consideration for this activity. Field formations are advised that while taxability in each case shall depend on facts of the case, the guidelines discussed above and jurisprudence that has evolved over time, may be followed in determining whether service tax on an activity or transaction needs to be levied treating it as service by way of agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act. Contents of Circular No. 178/10/2022-GST dated 3rd August. 2022, may also be referred to in this regard.”

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(Author can be reached at info@a2ztaxcorp.com)

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