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A Ryan LLC Affiliate

LITIGATION ALERT

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Damages under arbitral award and withdrawal of enforcement proceedings not taxable as 'supply of services' under Section 7 read with Entry 5(e) of Schedule II of the CGST Act

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Tata Sons Private Ltd. vs. Union of India & Ors. ¹

The Hon'ble Bombay High Court (HC) has held that payment of damages under a foreign arbitral award, and the consequential withdrawal of enforcement proceedings upon satisfaction of that award, does not amount to "supply of services" under Section 7 read with Entry 5(e) of Schedule II of the CGST Act, 2017, and accordingly cannot attract IGST on a reverse charge basis.

Background and facts

- NTT Docomo Inc. (Docomo), a Japanese company had entered into a Shareholders' Agreement (SA) dated March 25, 2009, with Tata Sons Private Limited (Tata/Petitioner) and in accordance with the SA, Docomo acquired 26% equity capital in the shares of Tata Teleservices Limited (TTSL)
- As per the SA in the event TTSL failed to satisfy certain conditions then Tata was obligated to find a buyer for Docomo's share at a 'Sale Price'.
- Upon TTSL's failure to meet certain performance indicators, disputes arose and Docomo initiated arbitral proceedings before the London Court of International Arbitration (LCIA), which by its award dated June 22, 2016, directed Tata to pay damages along with interest, arbitration costs and legal costs.
- For enforcement of the award, Docomo filed proceedings before the Delhi HC under Sections 47 and 48 of the Arbitration and Conciliation Act, 1996 and also initiated execution proceedings before courts in the United Kingdom and the United States of America.
- Before the Delhi HC, Tata and Docomo filed Consent Terms whereby Tata deposited Rs. 8,450 crores with the Court Registry, and Docomo agreed to suspend and subsequently withdraw the UK/US proceedings upon receipt of the full award amount. The HC declared the award enforceable as a deemed decree by its order dated April 28, 2017, and the award amounts were remitted to Docomo on October 30, 2017, and November 7, 2017.
- The Directorate General of GST Intelligence (DGGI) issued an intimation under Form DRC-01A demanding IGST from the petitioner, on the ground that Docomo, by agreeing under Clause 7 of the Consent Terms to withdraw UK/US enforcement proceedings and refraining from initiating further proceedings, had rendered a "supply of service" falling within Entry 5(e) of Schedule II to the CGST Act namely, "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act" and thus was liable to discharge IGST on a reverse charge basis treating the same as an import of service.
- A Show Cause Notice (SCN) to the same effect was issued under Section 74(1) of the CGST Act. Both the intimation and the SCN were challenged before the Bombay HC.

¹ 2026 (5) TMI 126

Contention of the petitioner:

- The payment made to Docomo was purely in the nature of damages awarded by the LCIA and enforced by the Delhi HC as a deemed decree and the withdrawal of enforcement proceedings was a natural legal consequence of satisfaction of the decree.
- CBIC Circular No. 178/10/2022-GST² explicitly clarifies that where liquidated damages are paid, there is no independent agreement to refrain from or tolerate an act and that such payments are not consideration for a supply and are not taxable. This position was reiterated in Circular No. 214/1/2023-Service Tax³. Both Circulars are binding on the department.
- The IGST provisions on import of services cannot be invoked in the absence of a "supply" under Section 7 of the CGST Act. Entry 5(e) of Schedule II can only be attracted where there exists an independent agreement, with separate consideration, under which a party in the course of business agrees to refrain from or tolerate an act.
- Relying on Raman Iron Foundry⁴, it was contended that damages does not even give rise to a debt until adjudicated by a court or arbitral tribunal.
- The SCN was without jurisdiction is as much as the transaction cannot be categorized as supply of any service considering Section 7 of the CGST Act and more particularly issued in open defiance of binding Board Circulars and therefore the writ petition was maintainable.

Contention of the Respondent:

- The DGGI contended that the Consent Terms introduced fresh contractual bargains beyond the award in particular, the six-month suspension period during which Docomo refrained from pursuing enforcement actions constituted a new independent agreement to tolerate non-payment, squarely attracting Entry 5(e). The consent terms went beyond what was

required by the award itself (which stipulated payment within 21 days).

- The writ petition was not maintainable as there was no inherent lack of jurisdiction, the DGGI had authority to issue the SCN.
- The applicability of the CBIC Circulars to the present facts was a question requiring adjudication before the designated officer and should not be decided in writ proceedings.

Findings of the court

- The Court held that Section 7 of the CGST Act requires, as a foundational condition, that supply be made or agreed to be made "for a consideration by a person in the course or furtherance of business."
- Entry 5(e) of Schedule II cannot be read in isolation from Section 7 of the CGST Act and it must operate within the principal charging provision and can only be attracted where there exists an independent agreement with distinct consideration under which a party binds itself to refrain from or tolerate an act.
- The enforcement proceedings initiated by Docomo before the UK, US and Delhi Courts were entirely ancillary to the arbitral award. Once the award debt was discharged in full, those collateral proceedings were legally incapable of being pursued and their withdrawal was not a fresh contractual obligation but an inevitable legal consequence of satisfaction of the decree.
- Clause 7 which of the Consent Terms merely did not create any independent obligation *de hors* the award, nor did it involve any separate consideration flowing beyond the award amount.
- The department's approach of reading into the consent terms an independent commercial arrangement attracting IGST was characterized by the Court as "quite an absurdity" and "wholly without jurisdiction and patently perverse."

² Circular No. 178/10/2022-GST dated August 3, 2022

³ Circular No. 214/1/2023-Service Tax dated February 28, 2023

⁴ Union of India v. Raman Iron Foundry (1974) 2 SCC 231

- The Court reaffirmed, relying on Raman Iron Foundry and Iron & Hardware (India) Co⁵, that damages do not give rise to any pecuniary liability until adjudicated by a court or tribunal and are not consideration for any contractual obligation.
- The Court held that CBIC Circular No. 178/10/2022-GST and Circular No. 214/1/2023-Service Tax were binding on the department, both of which clearly state that compensatory payments for breach of contract, where there is no independent agreement to refrain or tolerate, do not constitute supply and are not taxable. The DGGI's action in issuing the SCN in direct defiance of these circulars was found to be without any basis in law.
- On the question of alternate remedy, the Court reiterated that availability of an alternate remedy is a rule of policy and discretion and not an absolute bar to writ jurisdiction. Since the designated officer lacked jurisdiction to treat the settlement as a taxable supply under Section 7 read with Entry 5(e), the case fell squarely within the recognized exception permitting writ interference where proceedings are wholly without jurisdiction, reliance in this regard was placed on judgment of the SC in Godrej Sara Lee⁶ and Bombay HC in Mohd. Nooh⁷
- In the absence of an independent agreement with separate consideration, Section 7 of the CGST Act is simply not attracted, and neither Entry 5(e) nor the IGST provisions on import of services can be invoked.

Judgement

- The Court allowed the writ petition and quashed both the intimation under Form DRC-01A dated September 28, 2022, and the SCN dated July 26, 2023
- Payment of damages under an arbitral award does not constitute "supply of services" under Section 7 of the CGST Act, 2017.
- Withdrawal of collateral enforcement proceedings upon full satisfaction of an arbitral award does not create any independent taxable supply under Entry 5(e) of Schedule II.

⁵ Iron & Hardware (India) Co. v. Shamlal & Brothers, 1954 SCC OnLine Bom

⁶ Godrej Sara Lee Ltd. v. Excise & Taxation Officer (2023) SCC OnLine SC 95

⁷ State of U.P v. Mohd. Nooh, 1958 SCR 595

The Bombay High Court has reaffirmed its earlier position in the ruling of *Bai Mamubai Trust v. Suchitra wd/o. Sadhu Koraga Shetty*⁸ wherein it was held that violation of a legal right, and compensation to make right such violation of a legal right, is not considered as a 'supply' under Section 7 of the CGST Act.

The ruling provides significant relief and clarity to taxpayers who have faced or may face GST demands on payments made pursuant to arbitral awards or court decrees, particularly in cross-border disputes involving foreign award creditors.

The ruling firmly establishes that Entry 5(e) of Schedule II to the CGST Act is not a residual taxing provision capable of being applied to any arrangement involving forbearance it requires a specific, independent agreement with identifiable consideration, drawing a clear line between compensation for breach and consideration for supply. Further, the Court's reaffirmation that CBIC Circulars are binding on the department is equally noteworthy.

Overall, from a practical standpoint, the ruling is likely to substantially reduce instances of GST demands being raised on arbitral award settlements, liquidated damages, and court-sanctioned consent decrees, and provides strong precedential support for taxpayers to resist such demands at the SCN stage itself.

⁸ TS 736 HC 2019(BOM)-NT

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