



## Tax alert: **Bombay High Court holds that damages pursuant to arbitral award do not constitute 'supply' under GST**

**15 May 2026**

The Bombay High Court has held that damages paid pursuant to an arbitral award would not amount to “supply” under GST law.

### In a nutshell



The Bombay High Court has held that settlement of an arbitral award for breach of contract does not qualify as “supply” within the ambit of Section 7 of the CGST Act, read with entry 5(e) of Schedule II.



Such damages are purely compensatory in nature, arising from breach of contract and do not constitute consideration for any "supply" of services.



Withdrawal of enforcement proceedings is merely incidental to satisfaction of the award and cannot be construed as an independent act of “tolerating” or “refraining”, for consideration.



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## Background<sup>1</sup>:

- The petitioner company, P Pvt. Ltd. (P Co) is the principal investment holding company of an Indian conglomerate. It, along with D Inc, a Japanese company, invested in the shares of T Co as governed by a Shareholders' Agreement (SHA) in 2009.
  - The SHA specified certain performance indicators to be achieved by T Co. If T Co failed to meet the specified indicators, P Co was obligated to find a buyer for the shares owned by D Inc's at a "Sale Price."
  - T Co failed to satisfy the performance indicators, thereby triggering P Co's obligation to find a buyer for D Inc's shares. P Co was unable to fulfil this obligation, resulting in disputes between the parties.
- D Inc initiated arbitration proceedings before the London Court of International Arbitration (LCIA) in 2016, which culminated in an arbitral award directing P Co to pay damages, interest, arbitration costs and legal costs to D Inc.
  - Enforcement proceedings were initiated in the UK, the US, and in India. In India, the Delhi High Court declared the award to be enforceable in India in April 2017, and P Co deposited the award amount with the court registry in October and November 2017.
  - D Inc agreed to withdraw enforcement proceedings in the UK and the US pursuant to payment of the award amount.
- The Directorate General of GST Intelligence (DGGI) sought to levy GST on the damages paid pursuant to Delhi High Court decision. It was contended that the payments constituted taxable supply of services under entry 5(e) of Schedule II of the CGST Act, *i.e. agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act.*
- It was alleged that D Inc tolerated the contractual defaults by P Co and refrained from continuing any further proceedings against P Co in relation to the SHA and/or the Award which is a "supply of service".
- The Petitioner filed a petition before the Bombay High Court challenging the said GST demand.

## High Court judgement:

- The Court held that settlement of an arbitral award and payment of damages do not constitute consideration towards "supply" under Section 7 of the CGST Act on the following grounds:
  - The Court referred to the **CBIC Circular No. 178/10/2022-GST and Circular No. 214/1/2023-Service Tax**, which clarified that liquidated damages for breach of contract do not constitute consideration for a supply of services unless they arise from a distinct agreement to tolerate an act or refrain from acting.
    - There is no distinction between liquidated damages and damages awarded by the Civil court or an arbitral tribunal, as both share the same legal character *i.e.*, compensation for a breach of contract. In the present case, the arbitral award represents damages granted under Section 73 of the Indian Contract Act, 1872, for such breach.
    - Entry 5(e) of Schedule II must be read in the context of Section 7, which defines "supply".
  - D Inc's agreement to withdraw enforcement proceedings in UK and the US upon receipt of award amount was a natural corollary / logical consequence of the satisfaction of the decree. Once the decretal dues stood paid and accepted, any collateral recovery proceedings would cease to be relevant.

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<sup>1</sup> Tata Sons Private Ltd. Vs. UOI & Ors., WP No. 4914 of 2022 (Bombay High Court)

- It cannot be regarded as an independent agreement involving any consideration. Rather, it reflects the legal position, that a decree holder/award creditor loses the basis to pursue proceedings after the payment of award is made.
- Such withdrawal was incidental to and inextricably connected to the principal enforcement proceedings before the Delhi High Court concerning the arbitral award.
- The Court held that the designated Officer lacked jurisdiction to issue the impugned show cause notice, as the settlement of the arbitral award did not fall within the scope of "supply". This constituted a jurisdictional error, making the writ petition maintainable.
- Accordingly, the Court quashed the tax demand as well as the show cause notice issued by the Revenue.

**Comments:**

This is a welcome ruling explaining that settlement of an ‘arbitral award’ for a breach of contract does not constitute ‘consideration’ for a supply. It has very well explained that ‘liquidated damages’ and ‘unliquidated damages’ have the same legal character i.e., ‘compensation for a breach of contract’ and that entitlement to such damages becomes a ‘debt due’ only when it is determined and awarded by the arbitral tribunal. It has been emphasized that entry 5(e) of Schedule II must be read in the context of Section 7, which defines "supply". It has in different ways explained that the withdrawal of enforcement proceedings is a natural consequence/corollary / legal requirement/ incidental/ inextricably linked to the proceedings for enforcement of the arbitral award before the Delhi High Court which cannot be seen as an independent agreement and that the payment of the arbitral award was a payment towards the breach of contract and not a ‘consideration’ for withdrawal of enforcement proceedings.

The judgement would help defending cases where the department has invoked applicability of entry 5(e) of Schedule II, treating damages paid for breach of contract as ‘supply’.

One may want to evaluate taxability of such arbitral award from an income-tax perspective.

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