

**GOODS
AND
SERVICES
TAX**

**GST
UPDATES**

**GST IMPLICATIONS ON ARBITRAL AWARD FOR
WORKS/SERVICES EXECUTED/RENDERED IN PRE-GST PERIOD**

INTRODUCTION

Arbitration is particularly known as a mean of dispute resolution mechanism in the commercial sphere. Whenever there is a dispute between the parties to any contract, the same can be resolved by opting to arbitration. The arbitration tribunal hears both the parties and passes an award which is equivalent to a decree of court unless it is stayed.

An arbitral award may be rendered in the following forms of remedies to the aggrieved party:

1. The payment of the outstanding amount in relation to the contract in dispute.
2. The payment of a specified sum of money as compensation or liquidated damages for the breach of contract.
3. The payment of interest or penalties in instances where the dispute pertains to delays in payment of the contract.
4. The reimbursement of the costs associated with arbitration or the fees paid for the services of the arbitral tribunal.

Considering that the Goods and Services Tax (GST) Law was enacted in 2017, and arbitration procedure has been ongoing prior to the implementation of the GST, arbitral award granted may fall in the following scenarios:

1. Work completed prior to the implementation of the GST regime, and the dispute resolution process was also conducted during the same period.
2. Work completed prior to the implementation of the GST regime, but the dispute resolution process occurred during the GST period.
3. Work completed during the GST period, and the resolution of the dispute also took place during the same period.

GST IMPLICATIONS UNDER DIFFERENT SCENARIOS

The government has enforced some specific transitional provisions vide section 142 of the CGST Act, 2017 for the contracts entered into prior to the appointed day (i.e., 1st July, 2017) and the goods or services or both supplied on or after the appointed day. The same shall be dealt with in accordance with such provisions as provided in

GST Law. Our concern through this article is to draw attention on the GST implications that may arise where the contract is entered into as well as executed prior to the GST regime.

For the contracts that had already been executed in pre-GST period and dispute is also resolved in the same period, there would be no implications of GST on the amount of award received from arbitral tribunal. However, it is crucial to consider whether the GST would be applicable to the arbitral award received subsequent to the implementation of the GST regime in relation to the work that had already been completed prior to the GST's enactment.

Let us delve into the applicability of GST on various amount received as arbitral award-

1. The payment of the outstanding amount in relation to the contract in dispute:

Under GST Law, the time of supply (TOS) can be determined as per section 12 and section 13 of the CGST Act, 2017. Section 12 deals with the TOS in case of supply of goods which is the date of issue of invoice or last day on which invoice should have been issued. Whereas section 13 deals with the TOS in case of supply of services which is the earliest of the date of issue of invoice or date of provision of service or date of receipt of payment.

In the given case where supply was made prior to introduction of GST, only unpaid amount is received after GST period, the TOS cannot be occurred in GST period. Hence the amounts claimed pertaining to the works executed earlier to introduction of GST are not liable to tax under GST Law.

The same is also clarified by **Authority for Advance Ruling (AAR), Telangana** in the matter of **M/S. CONTINENTAL ENGINEERING CORPORATION** ('the applicant'). In this case, the applicant has executed works contract for M/s. Hyderabad Growth Corridor Ltd (HGCL). The work was completed in pre-GST era and the applicant raised certain

claims regarding compensation for delay in execution, payment of difference in rates and other contractual breaches. Below is held by the AAR, Telangana in this regard:

“The liability to tax under CGST/SGST Acts for works contracts is determined by the time of supply of services in Section 13 read with Section 31 i.e., the provisions pertaining to tax invoice. The time of supply of service according to Section 13(2) is the earliest of the date on which invoice is issued or date of provision of service or date of receipt of payment or date on which recipient shows the receipt of services in his books. As seen from the averments of the applicant the supply was made prior to introduction of GST. Therefore, it is not covered by Section 13(2) of the CGST/SGST Acts. Hence the amounts claimed pertaining to the works executed earlier to introduction of GST are not taxable under CGST/SGST Acts.”

2. The payment of a specified sum of money as compensation or liquidated damages for the breach of contract:

Breach or non-performance of contract by one party results in loss and damages to the other party. The party which suffers by such breach is entitled to receive from the other party compensation for any loss or damage caused to him by such breach. Earlier there were no clarity regarding the taxability of liquidated damages being received by the aggrieved party to the contract. However, the issue is well clarified vide **Circular No. 178/10/2022-GST dated 3rd August, 2022** which states that-

Para 7.1.3 *“Liquidated damages cannot be said to be a consideration received for tolerating the breach or non-performance of contract. They are rather payments for not tolerating the breach of contract. The liquidated damages or penalty are not the desired outcome of the contract.”*

The circular further provides a reasonable view with regard to taxability of liquidated damages in **para 7.1.4** that *“where the amount paid as ‘liquidated damages’ is an amount paid only to compensate for injury, loss or damage suffered by the aggrieved party due to breach of the contract and there is no agreement, express or implied, by the aggrieved party receiving the liquidated*

*damages, to refrain from or tolerate an act or to do anything for the party paying the liquidated damages, in such cases liquidated damages are mere a flow of money from the party who causes breach of the contract to the party who suffers loss or damage due to such breach. **Such payments do not constitute consideration for a supply and are not taxable.***

The issue is also considered in the matter of **M/S. TPSC (INDIA) PRIVATE LIMITED**, where AAR, Telangana held that *“Liquidated damages, without any supply of materials and labor, are not assessed to GST under GST Act, 2017. The damages are considered compensation for breach of contract and not for tolerating an act or situation, thus not constituting a supply under entry 5(e) of Schedule-II of the CGST Act, 2017”*.

Hence, the amount of arbitral award received as compensation or liquidated damages for the breach of contract shall not be taxable under GST Law.

3. The payment of interest or penalties in instances where the dispute pertains to delays in payment of the contract:

As per section 15(2)(d) of the CGST Act, 2017, amount received by way of interest or late fee or penalty for delayed payment of any consideration for any supply is includible in the value of such supply.

Further, the time of supply of such amount is determined by the provisions laid down under section 12(6) or 13(6) which says that the time of supply to the extent it relates to an addition in the value of supply by way of interest, late fee or penalty for delayed payment of any consideration shall be **the date on which the supplier receives such addition in value.**

Therefore, as per the analysis made hereinabove, it is valid to say that the arbitral award received as interest or penalties for delayed payments is taxable under GST Law since the amount is received only during the GST regime. The view can also be justified by relying on the ruling by AAR, Telangana in the matter of **M/S. CONTINENTAL ENGINEERING CORPORATION.**

4. The reimbursement of the costs associated with arbitration or the fees paid for the services of the arbitral tribunal:

As per **Entry No. 3 of Notification No. 13/2017- Central Tax (Rate) dated 28th June, 2017** as amended from time to time, services supplied by an arbitral tribunal to a business entity is liable to tax under Reverse Charge Mechanism (RCM) and the business entity located in the taxable territory is liable to pay tax on the said supply.

Reliance can also be placed on the ruling by AAR, Telangana in the matter of **M/S. CONTINENTAL ENGINEERING CORPORATION** which can be reproduced as below-

“The consideration received by arbitral tribunal is taxable on reverse charge basis under CGST & SGST Act @ 9% each. The service tariff code is 998215. In the present case, Arbitration as service was supplied independently after the introduction of GST i.e., the tribunal was constituted conclusively on 20.11.2017 and rendered its orders on 09.05.2019 and therefore, this supply is liable to tax on reverse charge basis under GST”.

In conclusion, to understand the GST implications on the arbitral award, examining the facts and contractual terms of each case is necessary to determine the character of the arbitral award. The above understanding is not free from disputes/GST Litigation.


DISCLAIMER:


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