

## **GST payable on amount received through Arbitration for work executed in pre-GST period**

The Hon'ble Telangana Authority for Advance Ruling ("**the AAR Telangana**") in the case of ***M/s. Continental Engineering Corporation [A.R. Com/18/2020 decided on October 8, 2021]*** has held that Goods and Services Tax ("**GST**") would be payable on the amount received through Arbitration for work executed in the pre-GST period.

M/s. Continental Engineering Corporation ("**the Applicant**") had executed a works contract for M/s. Hyderabad Growth Corridor Ltd ("**HGCL**"). The work was completed in pre-GST era and the Applicant had raised certain claims under an Arbitration proceeding regarding compensation for delay in execution, payment of difference in rates and other contractual breaches. An arbitration award was passed on 09.05.2019 for Rs.169,58,22,197/- to be paid to the Applicant.

In the grounds submitted by the Applicant, they had contended that the works were completed in the Pre-GST regime and that only money was receivable after introduction of GST due to arbitration award. They have asserted that the receipt of money is not taxable under the provisions of GST laws as it doesn't amount to supply of goods as money is excluded from the definition goods.

The Hon'ble AAR Telangana observed that as the amount received via the arbitration award would comprise a cost for the delays in performing contractual obligations, the amount shall fall within the meaning of consideration for tolerating an act or a situation arising out of the contractual obligation as given under entry 5(e) of Schedule II to the Central Goods and Services Tax Act, 2017 ("**the CGST Act**"). It was reiterated that the time of supply of the service of tolerance is the time when such determination takes place, which happened only by the arbitration award dated May 09, 2019. Therefore, the time of supply of this service as per Section 13 of the CGST Act is May 09, 2019. Accordingly, the amount received through Arbitration shall be taxable under the GST regime.

### **Our Comments:**

Earlier (before the Central Goods and Services (Amendment) Act, 2018) the same was dealt under Section 7(1)(d) of the CGST Act which included activities referred to in Schedule II to CGST Act, in the scope of supply. Paragraph 5 of Schedule II to the CGST Act provides a list of activities to be treated as either as 'supply of goods' or 'supply of services' wherein inter alia comprised Para 5- "*(e) agreeing to the obligation to refrain from an act, or to tolerate an act or situation, or to do an act*".

The Hon'ble Maharashtra AAR in the matter of ***Maharashtra State Power Generation Company Limited [Order No. GST-ARA- 15/2017-18/B-30, decided on May 8, 2018]*** held that GST at the rate of 18% would be payable on liquidated damages received by the Applicant for delayed supply under a contract and considered liquidated damages to be a consideration for agreeing to the obligation to tolerate an act or a situation, which is treated as a supply of service under Para 5(e) of Schedule II of the CGST Act.

Further, a similar view has been taken by the ***Hon'ble Gujarat AAR, in the matter of M/s. Dholera Industrial City Development Project Ltd. [Advance Ruling No. GUJ/GAAR/R/2019/06, decided on March 4, 2019]*** wherein it was held that Applicant is liable to collect GST on amount recovered from contractors on account of breach of conditions specified in the contract and the transaction shall be treated as supply of services. Moreover, as violation charges are payable by the contractors, the same are required to be treated as consideration. Therefore, the transaction is liable to GST.

However, vide Central Goods and Services (Amendment) Act, 2018, Section 7(1)(d) of the CGST Act was retrospectively omitted and a new sub-section i.e., Section 7(1A) of the CGST Act was inserted w.e.f. July 1, 2017. Consequently, all activities which were specified in Schedule II to the CGST Act would be only for determination of classification of transactions either as 'supply of goods' or supply of services' but, it would be chargeable to GST only if such transaction qualify as a supply in terms of Section 7(1) of CGST Act.

In our view, the levy of GST on recovery of compensation/penalty/damages depends upon the "test of supply" i.e., one has to satisfy that recovery of compensation/penalty/damages in itself is a supply, then only GST could be levied on it in terms of the insertion of sub-clause (1A) in Section 7 of the CGST Act read with omission of sub-section (d) of Section 7(1) of the CGST Act (vide Central Goods and Services Tax (Amendment) Act, 2018 w.e.f. July 1, 2017).

The Schedule II of the CGST Act is confined to define as to what constitute supply of goods or supply of services and does not defines supply *per se*. Schedule II of the CGST Act has to be read along with Section 7 of the CGST Act, which means if an activity does not constitute a "supply" in itself as per Section 7(1) of the CGST Act, mere coverage of the same under the entry Schedule II *ibid* cannot make it liable to GST.

Further, there is no positive act of supply of services between the parties and there is no agreement between the parties to cause loss or damage by breaching terms and

conditions of an agreement for a consideration. The expression 'to tolerate an act' relates to situations where a person commissions another person to do or commit a particular act for a consideration. The payment of cost for the delays in performing contractual obligations is a condition of contract and not a consideration for any service in the nature of forbearance or tolerating an act.

**Relevant provisions:**

Entry 5(e) of Schedule II to the CGST Act:

*"5(e): Agreeing to the obligation to refrain from an act, or tolerate an act, or a situation, or to do an act."*

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