

Contract Damages Are Not Supply: Reaffirming the Boundaries of GST in Breach of Contract Matters



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1. Introduction

The jurisprudence under GST has steadily evolved to draw a principled distinction between genuine commercial supplies and compensatory payments arising from contractual breaches. In *Tata Sons (P.) Ltd. v. Union Of India* [2026] 186 taxmann.com 52 (Bombay), the Hon'ble Bombay High Court, in a well-reasoned and significant decision, has once again reaffirmed this boundary. While quashing the demand raised by DGGI treating settlement amounts as consideration for “tolerating an act” under Entry No. 5(e) of Schedule II to the Central Goods and Services Tax Act, 2017, the Court carefully examined the statutory framework, relevant circulars, and prior precedents. The ruling not only clarifies the scope of “supply” but also prevents an over-expansive interpretation that could otherwise bring virtually every contractual settlement within the GST net.

Meaning and Scope of “Tolerating an Act” under Schedule II Entry 5(e)

Entry No. 5(e) of Schedule II deems as a supply of service an agreement to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act. However, the expression “tolerating an act” cannot be read in isolation or stretched to cover every instance where one party passively endures a breach by another. Jurisprudentially, “toleration” postulates a conscious, pre-agreed, and reciprocal arrangement wherein one party, for a consideration, agrees in advance to permit or endure a specified act or situation. It necessarily involves a positive act of assent embedded in the contractual framework, coupled with a clear quid pro quo.

In contrast, payments arising out of breach of contract—whether termed as damages, compensation, or settlement amounts—are not founded on any prior agreement to tolerate such breach. They are remedial in nature, intended to compensate the aggrieved party for loss suffered due to non-performance or deviation from contractual obligations. The element of reciprocity or supply is absent; the payment is not for any service rendered but is a consequence of a failure to perform. Therefore, mere acceptance of compensation cannot be equated with “tolerating an act.”

Thus, for Entry 5(e) to apply, there must exist: (i) a contractual obligation to tolerate an act or situation, (ii) a clear intention of the parties to treat such toleration as a supply, and (iii) consideration flowing specifically for such toleration. Absent these elements, the invocation of Schedule II Entry 5(e) would be legally unsustainable, as it would blur the fundamental distinction between a taxable supply and a compensatory remedy.

2. Factual Background

NTT Docomo Inc. (“Docomo”), a Japanese entity, had invested in Tata Teleservices Limited (“TTSL”) pursuant to a Shareholders’ Agreement (“SHA”), acquiring 26% equity. The agreement prescribed certain performance

benchmarks to be achieved by TTSL, failing which Tata Sons Pvt. Ltd. (“Tata”) was obligated to facilitate an exit for Docomo at a predetermined “Sale Price.” Upon non-fulfilment of these benchmarks, disputes arose, culminating in arbitral proceedings before the London Court of International Arbitration (LCIA).

The arbitral tribunal passed a unanimous award directing Tata to pay substantial damages to Docomo. Enforcement proceedings were thereafter initiated before the Delhi High Court, which recognized the award as enforceable, deeming it to be a decree of the Court. Tata deposited approximately ₹8,450 crores pursuant to the said order.

At this juncture, the Directorate General of GST Intelligence (DGGI) initiated inquiry proceedings, alleging that the payment constituted consideration for “tolerating an act,” thereby attracting GST under reverse charge as import of services. Despite Tata’s detailed submissions and reliance on Circular No. 178/10/2022-GST dated 3 August 2022, a DRC-01A and subsequently a show cause notice came to be issued, prompting Tata to approach the Bombay High Court by way of writ proceedings.

3. Issue Before the High Court

The core issue framed by the Hon’ble High Court was:

“Whether the settlement between the parties in the proceedings filed by Docomo under Sections 47 and 48 of the Arbitration and Conciliation Act, 1996 (ACA), under which the arbitral award for damages stood settled between the parties, would amount to “supply” within the definition of Section 7(1) of the CGST Act?”

4. Submissions of the Petitioner

On behalf of Tata, it was contended that the payment was purely in satisfaction of a decretal liability arising from an arbitral award, which itself was enforced by the Delhi High Court. The withdrawal of parallel enforcement proceedings in the UK and USA was merely a legal consequence of such satisfaction and not an independent contractual arrangement supported by consideration.

It was emphasized that damages awarded through arbitral or judicial determination do not constitute consideration for any supply, but are compensatory in nature. The petitioner further relied upon **Circular No. 178/10/2022-GST** to assert that such payments are not taxable under GST. The show cause notice, therefore, was argued to be *ex facie* contrary to settled legal principles and binding departmental clarifications.

Additionally, it was submitted that even a settlement or compromise of an arbitral award does not alter its intrinsic character as damages. The enforcement and satisfaction of a decree cannot be artificially dissected to infer a separate supply, particularly in the absence of any independent agreement or *quid pro quo*.

5. Submissions of the Revenue

The Revenue, on the other hand, argued that the writ petition was premature and that the adjudicating authority was competent to determine issues of taxability. It was contended that the consent terms entered into between Tata and Docomo introduced additional obligations, particularly the agreement by Docomo to refrain from pursuing enforcement proceedings for a specified period.

According to the Revenue, such forbearance constituted a distinct supply of service falling within the ambit of “agreeing to the obligation to refrain from an act or to tolerate an act,” as contemplated under Entry No. 5(e) of Schedule II. The suspension period, it was argued, went beyond mere compliance with the arbitral award and constituted an independent contractual arrangement attracting GST.

6. Discussion & Findings of the High Court

6.1 Scope of “Supply” under Section 7

The Court commenced its analysis by examining Section 7 of the CGST Act, emphasizing that the existence of “consideration” is a *sine qua non* for any transaction to qualify as a supply. Entry No. 5(e) of Schedule II, which

refers to obligations to refrain, tolerate, or do an act, cannot be read in isolation but must be interpreted in conjunction with the principal provision.

6.2 No Independent Agreement or Consideration

The Court categorically held that the consent terms did not create any independent agreement *de hors* the arbitral award. The obligations arising therein were intrinsically linked to the enforcement and satisfaction of the decree. In the absence of a separate agreement supported by consideration, the foundational requirement of “supply” remained unfulfilled.

6.3 Arbitral Award and Settlement as Integral Legal Process

A significant aspect of the judgment lies in recognizing that enforcement proceedings, including settlements recorded therein, are integral to the arbitral process. The Court observed that any arrangement facilitating satisfaction of the award is “intricately connected” to the decree and cannot be artificially segregated to infer a taxable supply. Collateral proceedings in foreign jurisdictions were merely extensions of the enforcement mechanism and naturally abated upon satisfaction of the award.

6.4 Interpretation of Entry 5(e) – “Tolerating an Act”

The Court rejected the Revenue’s expansive interpretation of Entry 5(e), holding that the expression “agreeing to the obligation” necessarily contemplates a conscious and independent contractual undertaking in the course of business. A mere consequence of legal enforcement or settlement cannot be equated with an agreement to tolerate an act.

6.5 Nature of Damages under Contract Law

Placing reliance on Sections 73 and 74 of the Indian Contract Act, 1872, the Court reiterated that damages are compensatory in nature, representing restitution for breach. Whether liquidated or unliquidated, their legal character remains unchanged—they are not consideration for any supply but a remedy for contractual violation.

6.6 Binding Nature of Circular No. 178/10/2022-GST

The Court also took note of Circular No. 178/10/2022-GST, which clarifies that liquidated damages are not taxable as they do not involve any agreement to tolerate an act. The Revenue’s attempt to distinguish between liquidated and adjudicated damages was rejected, with the Court holding that both stand on identical legal footing.

7. Final Findings of the Court

The Hon’ble High Court conclusively held that the settlement between Tata and Docomo did not amount to “supply” within the meaning of Section 7(1) of the CGST Act. The consent terms were merely a mechanism for effectuating the arbitral award and did not give rise to any independent contractual obligation. Consequently, neither the payment of damages nor the withdrawal of enforcement proceedings could be construed as a taxable supply of services. The demand raised by the DGGI was therefore quashed as being without jurisdiction and contrary to law.

8. Conclusion

The decision in *Tata* is a timely and necessary reaffirmation of the foundational principles governing GST. It draws a clear and principled line between **compensatory payments arising out of breach** and **consideration for a taxable supply**, preventing an overreach that could have far-reaching consequences across commercial litigation and arbitration. By recognizing that enforcement, settlement, and satisfaction of arbitral awards are part of a unified legal continuum, the Court has preserved the integrity of both contract law and tax law.

In an era where expansive interpretations often test statutory limits, this judgment restores doctrinal clarity—reminding us that not every flow of money is a supply, and not every obligation is taxable. For practitioners and businesses alike, it serves as a crucial precedent reinforcing that damages for breach and arbitral awards remain outside the ambit of GST, unless a clear, independent, and consideration-backed supply can be demonstrated.

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