GST Implications on Issues arising from Arbitration Awards

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We all know arbitration is one of the alternate dispute resolution mechanisms widely used. Whenever there is a dispute between the parties to the contract and the contract provides for arbitration, the dispute is to be resolved by opting to arbitration. Both the parties to the contract appoint an arbitrator and thereafter an arbitration tribunal gets constituted. The arbitration tribunal hears both the parties and passes an award. The award is equivalent to a decree of court unless it is stayed. The general trend is that the courts do not involve much in the arbitration matters respecting the party autonomy. Only in rarest occasions, the courts interfere with the awards. In other words, the award of the arbitration tribunal is almost final and binding on the parties.

With the above brief background on arbitration, we shall proceed in this article to deal with various issues that arise from the arbitration award that have implications under the GST laws. Needless to say, that the spectrum of arbitration is very wide, and it is not possible to cover analysis on each aspect. Hence in this article, we restrict ourselves to analysis of those major issues which we have handled.

Issue #1:

A contract has been entered prior to introduction of GST laws. The said work is exempted from payment of service tax. The service provider has completed the provision of service and claimed majority of the amounts under the said contract. There were certain disputes between the provider and receiver qua the price of the contract. The matter has reached arbitration after the introduction of GST laws and an award was passed in favour of provider allowing his claim for additional price. The recipient has agreed to pay the said amount. Now, the recipient pays the amount to provider in GST regime. Whether such amount is subjected to GST?

Response:

From the facts above, it would be evident that the provision of service has been completed during the service tax regime. The dispute is with relation to the price of the contract which has been completed in all respects. There is no supply happening during GST regime except for receiving the money as per the arbitration award.

In this background, let us proceed to examine the tax implications under the GST laws. Section 142(10) of CT Act[1] states that save otherwise provided, the goods or services or both supplied on or after the appointed day in pursuance of contract entered prior to the appointed day, shall be liable to tax under the provisions of CT Act. In other words, in light of Section 142(10), though the contract is entered prior to GST regime, if the goods or services or both are supplied during GST regime, then the tax under GST laws is applicable. However, the said section is subject to any other provisions dealing with similar situations.

This brings us to the provisions of Section 142(11)(b) and Section 142(11)(c). Section 142(11)(b) states that, notwithstanding anything contained in Section 13, no tax is required to be paid under the CT Act, to the extent that the tax was leviable on the said services under the provisions of service tax law.

[1] Central Goods and Services Tax Act, 2017

Section 142(11)(c) states that, where any tax was paid on a supply both under VAT[2] and service tax law, tax shall be leviable under the provisions of CT Act to the extent of supplies made after the appointed day and the taxable person is entitled to take credit of taxes that were paid under the earlier regime.

On a combined reading of Section 142(10), Section 142(11)(b) and Section 142(11)(c), the following scenarios are evident:

- If the service is already leviable under the provisions of service tax law, then there cannot be any tax under the provisions of CT Act to such an extent, notwithstanding anything contained in Section 13, that is time of supply for services.

- However, if a transaction is subjected to both VAT and service tax, let us say, a works contract service, then there will be a tax to the extent of supplies made under the GST regime, though the contract is entered prior to the GST regime. If the taxpayer has paid tax on such supplies (that are yet to be provided and provided in GST regime), he can claim the credit of such taxes.

In Scenario – 1, let us assume that the contract in the issue is a pure service. Then, in terms of Section 142(11)(b), there cannot be any tax under the provision of CT Act, though the amount is received under GST regime. This is because, the said service is leviable to tax under the service tax and hence the said service cannot be subjected to tax under the provisions of CT Act. This presents us with two incidental questions. One being, since the service is exempted during the service tax regime, can it be said to be 'leviable to tax' in terms of Section 142(11)(b), to fall under its ambit? Second, assuming we pass the muster of the first aspect, then, whether the receipt of amount under GST regime, would not create any tax implications under provisions of CT Act? Let us proceed to examine the same.

In our opinion, the issue is fairly settled, that 'leviable to tax' includes the scenarios, where there is no requirement to pay tax because of an exemption. Even the service is exempted, it can still be said, the same is leviable to tax. Payment of tax is fiscal aspect and should not be confused with the liability/leviable to tax. Hence, we can conclude that though the service is exempted under the service tax regime, we can still say that the same is leviable to tax and accordingly falls under the ambit of Section 142(11)(b).

The second issue, as to the receipt of the award amount during GST regime, would create any issue under the provisions of CT Act is to be now analysed. This also, in our view, should not create any issues, especially, when the provisions of Section 142(11)(b) use the expression 'notwithstanding anything contained in Section 13'. In other words, the receipt of payment may have created any issue in other situations, since the receipt also triggers the time of supply (that is time when tax is to be paid). However, since the provisions of Section 142(11)(b) in clear terms state that there cannot be any tax under the provisions of CT Act, notwithstanding anything contained in Section 13, the receipt alone cannot trigger any tax under CT Act.

In Scenario – 2, let us assume that the contract in the issue is a works contract service. In such a scenario, we must analyse the implications under the provisions of CT Act from the lens of Section 142(10) and Section 142(11)(c). From a close reading of the two sections, it would be evident that there would be tax implications under the provisions of CT Act, only where there are supplies made under the said Act. In the instant case, from the facts, it is evident that, there is no supply happening

[2] Value Added Tax

after the introduction of GST laws. The supply has been completed/terminated prior to GST regime. In such a case, there cannot be any tax under the provisions of CT Act, since there is no supply. However, the incidental question, that, whether receipt of award amount create any issues under the provisions of CT Act, needs to be analysed.

If one observes that expression 'notwithstanding anything contained in Section 13' used in Section 142(11)(b), however, not used for Section 142(11)(c). Would that make, the receipt of the amount taxable under the provisions of CT Act?

In our view, there cannot be any tax under the provisions of CT Act, without establishing a supply in the first place. As discussed earlier, since there is no supply during the GST regime, the receipt of money (award amount) cannot alone imply there will be a tax liability.

Issue #2:

A contract has been entered prior to introduction of GST laws. The said work is subjected to payment of service tax. The service provider has completed the provision of service and claimed majority of the amounts under the said contract. There were certain disputes between the provider and receiver qua certain additional works which the provider has done but not forming part of the contract. The provider has raised invoices/RA Bills for the works done on the service receiver. The service receiver has not accepted such invoices/RA Bills by stating that such works are not forming part of the original contract. However, the plea of the provider is that such additional work is mandatory, or situation based which must be done to complete the contracted work.

The matter has reached arbitration after the introduction of GST laws and an award was passed in favour of provider allowing his claim for additional work. The recipient has agreed to pay the said amount. Now, the recipient pays the amount to provider in GST regime. Whether such amount is subjected to GST?

Response:

In this case, the dispute is not qua the additional price but for the additional services provided. However, such services were provided under the service tax regime. Further, the provider has raised invoices/RA Bills on the service receiver. The same were not accepted. Since, the provider has to pay tax on accrual basis, the receipt of payment from the receiver does not have any bearing on the obligation to pay tax. Hence, the provider should have paid service tax. In such a case, there cannot be any tax under GST regime, because, there were no supplies made during GST regime. Since the service is leviable to tax under the provisions of service tax law, the same will not be subjected to tax under Section 142(11)(b) and since there are no supplies during GST regime, the taxability under Section 142(11)(c) would also does not kick in. Hence, the service provider is liable to service tax and not GST.

Further, if the service provider is waiting for the certification of the service receiver to raise invoice/RA Bills, then, the question arises, what tax is required to be paid? Even in such case, since the service receiver has now approved the service done (in light of instructions of the arbitration tribunal), the appropriate tax would be service tax. The provider should raise an invoice with service tax, collect the same and remit to the credit of the government. The receiver would lose an opportunity to claim the credit of such tax because the timing of such payment is not in alignment with the prescribed timeline to carry erstwhile credits to GST regime.

As discussed as part of Issue #1, the receipt of amount in GST regime, by itself, would not trigger any obligation under GST laws. Since there is no supply happening under GST laws, the receipt of consideration will not attract tax.

Issue #3:

A contract has been entered prior to introduction of GST laws. The said work is chargeable to tax under the service tax regime. The service provider has completed the provision of service and claimed majority of the amounts under the said contract. There were certain disputes between the provider and receiver qua the duration of contract. The provider argued that the recipient has breached the terms of contract thereby resulting a loss to the provider. The matter has reached arbitration after the introduction of GST laws and an award was passed in favour of provider allowing his claim for the amounts incurred for additional period as damages. The recipient has agreed to pay the said amount. Now, the recipient pays the amount to provider in GST regime. Whether such amount is subjected to GST?

Response:

In this case, the primary thing that comes to mind is, whether the taxability must be analysed from service tax law or GST laws? We have done an analysis of similar question qua Issue #1 above. We have concluded that the said services are taxable under the service tax alone and not GST, just because there was a receipt during GST regime.

We shall take the above conclusion and move forward making necessary changes because of change in facts in this issue.

Since the service was taxable during the service tax regime, the question that arises is, whether the said amount is taxable under the service tax law? To answer this, we need to examine the nature of amount which was received. Whether the said amount is for provision of additional work or provision of any service or just receipt of damages for breach of contract? The answer to this would determine the taxability. If it was for additional work or for provision for service, then there is no doubt on applicability of service tax. However, if it is damages, then we must examine, whether such determination/receipt of damages attracts tax under the service tax law? Let us proceed to examine the same.

From the facts, it is evident that the amount takes the colour of damages, because the provider is seeking amount for the violation of terms of contract and not for provision of any additional work. Since there is no additional work provided, there would not be any tax implication unless the amount can be considered as consideration for any other service provided. Is there any other service provided by the provider? Can we call the toleration of delay by the service provider is a service [declared service qua Section 66E(e)] and accordingly the amount received from the receiver is a consideration for such service?

In our view, the above seems doubtful. The amount received by provider is for the breach of terms of contract by recipient and are damages but not a consideration for toleration of an act. This is also cleared by Circular 178/10/2022 dated 3rd August 2022. The Circular stated where there are damages for violation of contract, they are to be treated as mere flow of money and not a consideration for any services provided. Accordingly, we can conclude that the said receipt of damages is not subjected to service tax.

Another issue that springs up is, if the damages are to be treated as mere flow of money from one person to another person, then such a transaction would be out of the definition of 'service' under Section 65B(44). Once the said transaction is out of the ambit of 'service', then one may argue that it

has not pass the muster of Section 142(11)(b), thereby inviting the analysis under the GST laws, because the said amount has been received during the GST regime.

In our view, the said transaction does not also satisfy the definition of 'service' under Section 2(102), because of specific exclusion for transaction in money. Since the Circular 178 has clarified that the same is mere flow of money, the said transaction cannot also be subjected to tax under the GST laws based on the aspect of receipt.

Issue #4:

Continuing with facts from Issue #3, let us assume that the arbitration tribunal, apart from the principal claim, also allowed claim for interest on the award amount. In such case, whether the said interest is subjected to tax?

Response:

This issue seems interesting for two reasons. One, what would be the nature of interest? Two, whether there can be a tax under GST laws, especially, in light of Section 15(2)(d) of CT Act, when there was no supply in first place? Let us proceed to explore both the aspects.

The first aspect is, what is the nature of interest? Will it have the same nature or different from the principal? This is important because, if the interest takes colour from the principal, then in the instant case, the interest can also be called as damages. If not, the taxability of interest must be examined in a separate hue than the damages.

In our view, the main reason for award of interest is to compensate the time value of money. Hence, the interest should take the colour of the principal amount. Since, in the instant case, the interest is awarded by the arbitration tribunal for damages, the interest pay out shall also take the colour of damages. As discussed above, since damages are mere flow of money, there will not be any tax implications on the receipt of interest.

The second aspect is, since interest for delayed payment of consideration for supply is to be included in the transaction value as per Section 15(2)(d), will interest be taxable? In our view, since in the instant case, there is no supply of service or goods or both, just mere transaction in money, damages being flown from one party to another, the question of transaction value would not only arise. Then, in such a scenario, how can interest be included in the transaction value in terms of Section 15(2)(d). In other words, in order to include the interest in transaction value, the interest should be for delayed payment of consideration and that consideration should be for a supply. In absence of supply, the interest cannot be brought to tax.

The Bombay High Court in the case of Angerlehner Structural and Civil Engineering Company vs. Municipal Corporation of Greater Bombay[3] has dealt with taxation of interest arising from arbitration award. The High Court stated that the interest arising from arbitration amount should be taxable under Section 15(2)(d) of CT Act, though the arbitration dealt with a contract which was entered prior to GST laws and award was also issued prior to introduction of GST laws. The High Court has gone by the fact that the amount of interest is being received after introduction of GST laws, the same was taxable under the provisions of GST laws.

[3] 2022 (6) TMI 424 – Bombay High Court

However, in our view that the above judgment has concentrated mainly on the aspect, whether the said amount is taxable under forward or reverse charge (because the supplier is entity outside India) and not, whether the said amount is actually taxable under the provisions of GST laws. The Court vide Para 8 stated that if the supplier is contesting on applicability of GST on the interest amount, then they are obliged to hear the Union of India. Since, the supplier has not insisted on the same, the Court proceeded to examine the second issue, as to who is liable to pay the tax (on the presumption that GST is liable) on such amounts. Hence, the above judgment should be taken with the above aspect in background and cannot be applied universally.

Issue #5:

Continuing with the common facts above, the arbitration tribunal apart from the award of the principal amount and interest, also awarded the service provider certain costs incurred by him for the arbitration proceedings. The arbitration tribunal has asked the service receiver to pay 50% of the costs incurred by service provider towards arbitration proceedings apart from payment of other amounts. In such case, whether there will be any tax implications on the awarded arbitration cost to the service provider, when he receives the same from the service receiver?

Response:

This is one of the most common issues. The arbitration tribunal as the final aspect before passing award, also awards costs incurred by the successful party to be reimbursed by the other party. Depending upon the facts and various other parameters, the tribunal concludes that the losing party must pay the winning party, partial or full amount incurred on arbitration proceeding by the winning party. In such cases, whether such amounts paid by service receiver (the losing party) to the service provider (the winning party) attract tax under GST laws?

Let us proceed to examine the same by taking an example. Let us say, the service provider has incurred Rs 1 Crore as cost towards the arbitration proceedings. The same includes, the fee paid to arbitral tribunal, the fee paid to the advocates who represented the service provider and other incidental expenses. Now, having won the dispute, the arbitration tribunal asked, service receiver to pay 50% of the above amount to the service provider. Now, the service receiver must pay 50% of Rs 1 Crore in line with the arbitration award. Should the service provider have to put tax on the said amount while raising the invoice for collecting the above amount from the service receiver?

In our view, the above transaction does not attract tax. The sole reason is that there is no supply happening from the service provider to the service receiver. The service receiver is paying only on the instruction of the arbitration tribunal, certain portion of the cost incurred, but not as a consideration for any supply. Hence, there should not be any tax on that particular transaction.

Further, the tax to be paid under reverse charge mechanism is for the services provided by the arbitral tribunal to a business entity. This is clear from Entry 3 of Notification No 13/2017 – CT (R) and accordingly reverse charge kicks only when the payment is made to the arbitral tribunal but not inter-se. In simple words, when the service provider and service receiver pay the arbitral tribunal, their respective share of fees, then the said transactions are taxable under reverse charge, independently, in their own hands. However, when one party is paying the other party, the cost incurred as a result of direction of arbitral tribunal, there cannot be a tax under reverse or forward charge.