



Disputes arising due to COVID-19 pandemic – GST implications

The COVID-19 pandemic continues to pose several challenges to the domestic as well as international economic and commercial market. This pandemic has led to a temporary suspension of global trade operations and brought the world to a standstill. The outbreak has a far-reaching impact on the ability of businesses to honor their commitments, resulting in issues such as businesses taking shelter under force majeure clauses, termination of contracts, forfeiture of advances, re-negotiation of contracts to name a few. Handling these challenging times may require organizations to forecast and evaluate possible defaults in honoring their commitments well in advance and adopt suitable strategies to mitigate the risks.

Issues and possible GST implications

In order to get a complete picture and minimize unforeseen risks, it is imperative to ensure that such evaluations and strategies account for their GST impact as well. An insight into a few issues caused by failure to honor business commitments due to the pandemic and the GST exposure on the same is captured below.

Scenario	Issue(s) involved	Possible tax-implication and outcome
<p>Force majeure</p> <p>[Background: In contracts where parties require the contractual terms to remain in effect until the force majeure subsides, the contracts are usually settled with a temporary suspension of some obligations, e.g., delayed payment to vendors]</p>	<p>GST law requires payment to the vendor within 180 days from the date of invoice to avail Input Tax Credit (ITC).</p>	<p>The recipients in this situation must ensure that they do not default in payment to vendors, else they would have to reverse the corresponding ITC along with applicable interest.</p> <p>In order to mitigate the impact of the current situation, relaxation from the government for reversal of ITC or an increase in the time-limit of 180 days would be welcomed. Interestingly, the 28th GST Council meeting had recommended an amendment to the CGST Act to remove the interest liability in case of such reversal. However, the said recommendation never saw the light of legislative approval. The government can re-consider this recommendation to provide relief to businesses.</p>
<p>Termination of contract</p> <p>[Background: Upon early termination, defaulting party may be required to pay an agreed sum to the other party in the form of damages or penalty]</p>	<p>Whether such amounts received on early termination of contracts can be treated as 'consideration' for a 'supply' under the GST law?</p>	<p>As per FAQ's under GST –</p> <p>Fines and penalties imposed for breaking the law is not 'consideration' for a 'supply' under GST.</p> <p>However, in the present scenario, the fine/penalty is being paid for breach of contract as against a breach of law.</p> <p>There are split views on this matter – Allahabad Tribunal in case of K.N. Food Industries Pvt. Ltd. held them to be not taxable on account of the following observations:</p> <ol style="list-style-type: none"> compensation is to make good any possible damages In an eventuality which is uncertain It does not emanate from any obligation to tolerate an act. <p>However, various advance rulings under the GST law [mentioned below] have held such penalty/fines for breach of contractual terms to be taxable by considering it as a separate consideration for tolerating an act - (a) <i>Dholera Industrial City Development Project Ltd.</i> - Gujarat AAR- GST, (b) <i>Rashtriya Ispat Nigam Ltd.</i> – Andhra Pradesh AAR GST (c) <i>M/s Chennai Port Trust</i> - Tamil Nadu AAR GST (d) <i>Maharashtra State Power Generation Co. Ltd.</i> - Maharashtra AAR GST</p> <p>Given the above, the government should consider issuing a clarification on this aspect to minimize the possibility of protracted litigation in the future.</p>

Scenario	Issue(s) involved	Possible tax-implication and outcome
<p>Forfeiture of advances and deposits</p> <p>[Background: Whether such forfeited advance/deposit will be subject to GST as being 'consideration' for supply]</p>	<p>Whether such a forfeited advance/deposit will be subjected to GST as being a 'consideration' for 'supply'?</p>	<p>As per FAQ's under Service tax –</p> <ol style="list-style-type: none"> Advances represent consideration for the service agreement. Hence, it is taxable. If forfeited deposits relate to accidental damages due to unforeseen action not relatable to the provision of services, then such forfeited deposit would not be regarded as 'consideration.' <p>However, under GST law, the AAR, Uttarakhand in Parvatiya Plywood (P) Ltd., has ruled that such a forfeited amount should be chargeable to GST as it is 'consideration' for tolerating an act.</p> <p>Given the above, the government should consider issuing a clarification on this aspect to minimize the possibility of protracted litigation in the future.</p>
<p>Encashment of bank guarantee</p> <p>[Background: In accordance with the indemnity clause, the principal indemnifies the surety upon encashment of guarantee by the creditor.]</p>	<p>Whether the amount paid by the principal to the surety shall be subject to GST?</p>	<p>As per Ruling GSTR-2006/1 under Australian GST –</p> <p>The payment constitutes the principal's obligation under the contract or in accordance with the law. There is no supply to the principal by the surety in consideration of the payment. Hence, it is not taxable to GST.</p> <p>Under the Indian GST law, such payments should be considered as transactions in money or as pure agent reimbursements, which should not be subject to GST. It is possible that the Revenue may proceed to bring such payments under the ambit of GST. Therefore, the government should consider issuing a clarification on this aspect as well.</p>

Considering the above aspects, the businesses would have to revitalize their strategies by implementing certain measures, which include revisiting contractual terms, proposing amendments to relevant clauses, etc. to avoid future disputes and litigation. On the other hand, businesses would also require further assistance from the government by way of effective measures to tide over the unprecedented crisis created by the pandemic. Further, relaxation from stringent GST provisions and/or appropriate clarification on GST implications in case of breach of contracts which appear to be a new normal in the short and medium-term in the post-COVID-19 era, would surely help businesses to manage their stretched cash flows effectively in this tough situation as well as avoid protracted litigation in the future.

COPING WITH COVID-19

Insights on business operations against the backdrop of the pandemic

About Nexdigm (SKP)

Nexdigm (SKP) is a multidisciplinary group that helps global organizations meet the needs of a dynamic business environment. Our focus on problem-solving, supported by our multifunctional expertise enables us to provide customized solutions for our clients.

Our cross-functional teams serve a wide range of industries, with a specific focus on healthcare, food processing, and banking and financial services. Over the last decade, we have built and leveraged capabilities across key global markets to provide transnational support to numerous clients.

We provide an array of solutions encompassing Consulting, Business Services, and Professional Services. Our solutions help businesses navigate challenges across all stages of their life-cycle. Through our direct operations in USA, India, and UAE, we serve a diverse range of clients, spanning multinationals, listed companies, privately owned companies, and family-owned businesses from over 50 countries.

Our team provides you with solutions for tomorrow; we help you *Think Next*.

Contact Us

India - Mumbai

Urmi Axis, 7th Floor
Famous Studio Lane, Dr. E. Moses Road
Mahalaxmi, Mumbai 400 011
India
T: +91 22 6730 9000

UAE - Dubai

Emirates Financial Towers
503-C South Tower, DIFC
PO Box 507260, Dubai
UAE
T: +971 4 2866677

USA - Chicago

2917 Oak Brook Hills Road
Oak Brook, IL 60523
USA
T: +1 630 818 1830

ThinkNext@nexdigm.com

www.nexdigm.com

www.skpgroup.com



@nexdigm



@nexdigm_



@NexdigmThinkNext



@Nexdigm



This document contains proprietary information of Nexdigm Private Limited and cannot be reproduced or further disclosed to others without prior written permission from Nexdigm Private Limited unless reproduced or disclosed in its entirety without modification.

Whilst every effort has been made to ensure the accuracy of the information contained in this paper, the same cannot be guaranteed. We accept no liability or responsibility to any person for any loss or damage incurred by relying on the information contained in this document.