

May 2026

Compensation received for losses caused by defective aircraft engines is not 'supply' under the goods and services tax laws - Delhi High Court

The High Court of Delhi (“**Delhi HC**”), in *InterGlobe Aviation Limited vs. Additional Commissioner CGST South Commissionerate and Ors.*¹, has, by way of an interim order, taken a *prima facie* view that the compensation received by InterGlobe Aviation Limited (“**Petitioner**”/“**IndiGo**”) towards business loss caused by non-performance cannot be termed as ‘supply’ within the meaning of Section 7 of the Central Goods and Services Tax Act, 2017 (“**CGST Act**”). The Delhi HC accordingly directed that no coercive action be taken against the Petitioner during the pendency of the writ petition.

Brief facts

1. The Petitioner had entered into an agreement with an overseas entity for the procurement of aircraft engines and spare engines.
2. Certain operational issues arose in the engines, on account of which the Petitioner suffered significant revenue loss owing to flight cancellations, flight delays and frequent repair requirements.
3. Taking note of the losses suffered by the Petitioner, the overseas entity agreed to grant compensation to the Petitioner in lieu of such losses.
4. The Respondent department raised a Goods and Services Tax (“**GST**”) demand of approximately INR 458,26,00,000 (Indian Rupees four hundred and fifty-eight crore twenty-six lakh) on the compensation so received, alleging it to be consideration for the service of ‘tolerating an act’.

Issues

The Delhi HC framed the following question for its consideration:

1. whether the compensation received by the Petitioner from the overseas engine manufacturer towards business losses caused by the defective aircraft engines can be said to be ‘supply’ within the meaning of Section 7 of the CGST Act and accordingly attract a tax liability; or
2. whether such compensation stands excluded from the definition of ‘supply’ in view of the Circular No. 178/10/2022-GST dated August 3, 2022 (“**Circular**”), particularly Clause 7 and Clause 7.1 of the Circular?

¹W.P.(C) 7271/2026, CM Appl. 35551/2026 & CM Appl. 35552/2026; Order dated May 22, 2026 (Nitin Wasudeo Sambre and Ajay Dignpaul, JJ.).

Findings and analysis

On a *prima facie* reading of Clause 7 and Clause 7.1 of the Circular and having regard to the definition of service under Section 7 of the CGST Act, the Delhi HC observed that the amount received by the Petitioner was towards compensation and could not, in any manner, be termed as 'supply' under Section 7 of the CGST Act. The matter has now been listed for August 31, 2026.

Conclusion

The outcome of the matter is likely to be based on the framework set out in the Circular, which clarifies when payments arising out of breach or non-performance of a contract could attract GST.

Under the CGST Act (*Schedule II, Para 5(e)*), agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act is declared as a supply of service, if the same constitutes 'supply' within the meaning of the CGST Act.

However, Clause 7 of the Circular clarifies that an agreement to tolerate an act cannot be presumed merely because money flows from one party to another. Payments such as liquidated damages for breach of contract are not consideration for tolerating an act; they are amounts recovered for not tolerating the breach and for deterring non-performance and are thus mere events in the course of the contract.

Clause 7.1.4 of the Circular further clarifies that where an amount is paid only to compensate for the loss or damage suffered on account of breach, and there is no agreement, express or implied, by the recipient to refrain from or tolerate an act or to do anything in return, such amount is a mere flow of money. It does not constitute consideration for a supply and is not taxable.

Applying this framework, the Petitioner's case is that the compensation received from the overseas entity is referable only to the losses caused by the defective engines. Contrary to the department's claim that it is consideration for 'tolerating an act', the amount is, if anything, recovered for 'not' tolerating the breach and is, in any event, not the price for any independent obligation undertaken by the Petitioner to tolerate, refrain from or do any act. It is therefore a mere flow of money that does not constitute consideration for a supply. On a *prima facie* view, the Delhi HC appears to have accepted this position.

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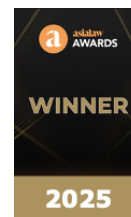
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