

Does Non-payment of Stamp Duty Affect Enforceability of Arbitration Agreements?

There is, often, a complex interplay between transnational legal standards for the enforcement of commercial contracts and various domestic legislations. One such category of legislations in India which affects, and sometimes delays, the enforcement of arbitration agreements are legislations relating to collection of stamp duty, in particular the Indian Stamp Act, 1899 (the "**Stamp Act**") and certain state-specific legislations relating to collection of stamp duty (collectively, the "**Stamp Duty Law**").

Under the Stamp Duty Law, an insufficiently stamped instrument is liable to be impounded.¹ Further, until such an instrument is sufficiently stamped, the instrument remains inadmissible in evidence.²

What then is the fate of an arbitration clause within an instrument that is either not stamped or insufficiently stamped? Will the relevant authority before which such instrument is presented under the provisions of the Arbitration and Conciliation Act, 1996 (the "**Arbitration Act**") refuse to refer the parties to arbitration; appoint an arbitrator; grant interim relief sought by the party? Or, would the separability doctrine (that an arbitration agreement is separate and distinct from the substantive contract in which it is contained) salvage such an arbitration clause?

STAMP DUTY LAW AND THE POLICY OBJECTIVES

The levy of stamp duty on an instrument is a fiscal measure whereby the government levies a duty on the execution of instruments with the objective of generating revenue. The Stamp Act is the central fiscal statute laying down the law relating to stamp duty

¹ Section 33, Indian Stamp Act, 1899.

² Section 35, Indian Stamp Act, 1899.

on instruments specified in Entry 91³ of the Union List of the Constitution of India (the “**Constitution**”). These instruments, on which stamp duty is levied by the Central Government, include, *inter alia*, bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts. For instruments executed outside of the territory of India, stamp duty is required to be paid within three (3) months of its receipt within the territory of India.⁴ Stamp duty on instruments other than those mentioned in Entry 91 is levied by the states as per Entry 63⁵ of the State List of the Constitution.

Section 2(14) of the Stamp Act defines an “instrument” to include a document by which “*any right or liability is or purported to be created, transferred, limited, extended, extinguished, or recorded*”. Schedule I to the Stamp Act lists the instruments on which stamp duty becomes payable and the amount of stamp duty on each such instrument. An insufficiently stamped instrument is inadmissible as evidence⁶ and liable to be impounded and returned only after the requisite stamp duty along with penalty has been paid.⁷ However, the non-stamping of any document is a defect which can be cured by following the procedure laid down under the Stamp Duty Law.

It is relevant to note that ‘arbitration agreements’ are not identified in Schedule I of the Stamp Act as instruments which are required to be stamped. However, one may argue that for an agreement not identified in Schedule I of the Stamp Act (in this case, an arbitration agreement), stamp duty becomes payable in terms of the rest and residuary provision of the Stamp Act.⁸

REQUIREMENTS OF AN ARBITRATION AGREEMENT UNDER THE ARBITRATION ACT

The substantive and formal requirements of an arbitration agreement are prescribed under Section 7 of the Arbitration Act. Section 7 provides that an arbitration agreement must be (a) in writing; and (b) contained in, either a document signed by the parties or an exchange of correspondence between the parties which provides a record of the agreement, or an exchange of statements of claim and defence containing an undisputed acknowledgement of the agreement. As a matter of practice, most such

³ Constitution, Schedule VII, List I – Union List.

⁴ Section 18, Indian Stamp Act, 1899.

⁵ Constitution, Schedule VII, List II – State List.

⁶ Section 33, Indian Stamp Act, 1899.

⁷ Section 35, Indian Stamp Act, 1899.

⁸ Article 5(c) of Schedule I, Indian Stamp Act, 1899.

arbitration agreements exist within a broader agreement which records the transaction contemplated. In other cases, the arbitration agreement is incorporated by reference to another agreement containing an arbitration clause.

Simply put, therefore, there is no specific requirement under the Arbitration Act that mandates an arbitration agreement to be stamped.

SMS TEA ESTATES TO NN GLOBAL: THE EVOLVING JUDICIAL POSITION

The judicial position on the enforceability of an arbitration agreement contained in an unstamped or insufficiently stamped agreement can be traced to the Supreme Court of India (the “**Supreme Court**”)’s 2011 decision in *SMS Tea Estates Pvt. Ltd. v. Chandmari Tea Company Pvt. Ltd.*⁹ (“**SMS Tea Estates**”) where it was hearing an application under Section 11 of the Arbitration Act for the appointment of an arbitrator. The Supreme Court observed that the arbitration agreement in an unstamped or insufficiently stamped instrument was invalid, given that Section 35 of the Stamp Act expressly bars the authority before which such unstamped or insufficiently stamped instrument is presented to act on such instrument. Accordingly, the Supreme Court held that before “acting upon” the arbitration clause and appointing an arbitrator, the instrument containing the arbitration clause should be impounded and the deficit stamp duty must be paid. Although the Supreme Court referred to the separability doctrine, it failed to give effect to the doctrine. In its view, since a court could not act upon an unstamped instrument, it was also precluded from enforcing the arbitration clause contained within such instrument.

SMS Tea Estates was decided prior to the Arbitration and Conciliation (Amendment) Act, 2015 (the “**2015 Amendment**”), when the court tasked with appointing an arbitrator could determine issues beyond examining the existence of the arbitration agreement. Section 11(6A) of the Arbitration Act, which was introduced through the 2015 Amendment, narrowed the scope of inquiry by a court to examining only the “existence” of an arbitration agreement.

A full bench of the Bombay High Court had the opportunity to examine the effect of *SMS Tea Estates* on Section 11(6A) of the Arbitration Act in *Gautam Landscapes Pvt. Ltd. v. Shailesh S. Shah*¹⁰ (“**Gautam Landscapes**”) where it was deciding an application for interim relief under Section 9 of the Arbitration Act. The Bombay High

⁹ (2011) 14 SCC 66, para 12.

¹⁰ 2019 SCC OnLine Bom 563, para 69.

Court noted that since the very purpose of filing a Section 9 application is to seek *ad interim* or interim reliefs, the requirement to impound the agreement and directing the payment of the deficit stamp duty as set out in *SMS Tea Estates*, especially after the introduction of Section 11(6A), would lead to undermining the legislative intent behind the 2015 Amendment. Accordingly, the Bombay High Court, relying on the separability doctrine, held that a deficit in stamp duty payable on an instrument would not invalidate the arbitration clause contained in such instrument and that the court is empowered to act not only on the application for interim relief but also on the application for appointing an arbitrator.

The separability doctrine came to be visited by the Supreme Court in *Garware Wall Ropes v. Coastal Marine Constructions and Engineering Limited*¹¹ (“**Garware Wall Ropes**”) where the Supreme Court was hearing an application for appointment of arbitrator under Section 11 of the Arbitration Act. In that case, the Supreme Court was of the view that the separability doctrine, which was enshrined in Section 16 of the Arbitration Act, does not come into effect before an arbitral tribunal is constituted. The Supreme Court cited *SMS Tea Estates* with approval.

However, this view was problematic for two reasons: first, the separability doctrine is treated as a fundamental principle of arbitration under both civil and common law jurisdictions; and second, the separability doctrine is expressly recognised under Sections 7 and 16 of the Arbitration Act¹². Therefore, *Garware Wall Ropes*, by choosing to restrict the operation of the separability doctrine to only cases where the arbitral tribunal has been constituted, negated the effect of Section 11(6A) and restored the position in *SMS Tea Estates*.

A couple of years later, in *N.N. Global Mercantile Pvt. Ltd. v. Indo Unique Flame Ltd*¹³ (“**NN Global**”), while hearing an application seeking a reference to arbitration under Section 8 of the Arbitration Act, the Supreme Court upheld the separability doctrine and issued a finding that an arbitration clause in an unstamped or insufficiently stamped instrument would survive independent of the validity of the broader agreement. Accordingly, the Supreme Court expressly overruled *SMS Tea Estates*. However, since the decision in *Garware Wall Ropes* was affirmed by a division bench of coordinate strength (three judges) in *Vidya Drolia and Others v. Durga Trading*

¹¹ (2019) 9 SCC 209, para 15.

¹² *Enercon (India) Ltd. v. Enercon GmbH*, (2014) 5 SCC 1; *Ashapura Mine-Chem Ltd. v. Gujarat Mineral Development Corporation*, (2015) 8 SCC 193.

¹³ (2021) 4 SCC 379, para 6.8.

*Corporation*¹⁴, the issue of separability doctrine has been referred to a Constitution Bench comprising of five judges of the Supreme Court to finally decide the controversy, which is presently pending (the “**Reference**”).

Recently, when this issue came up before the Supreme Court in *Intercontinental Hotels Group v. Waterline Hotels Pvt. Ltd*¹⁵, the Court observed that disputes in such matters could not be left hanging and, that courts should ensure that arbitrations are proceeded with until the Reference is decided.

UPHOLDING THE SEPARABILITY DOCTRINE IN THE REFERENCE

After the Supreme Court’s decision in *SMS Tea Estates*, the issue of non-stamping and insufficient stamping of commercial contracts became an easy objection for recalcitrant parties to raise in order to forestall interim reliefs and delay the adjudication of claims. It often delayed arbitrator appointments and the grant of interim reliefs until the defect in stamping was cured, an unacceptable position for any credible jurisdiction.

In our view, the following points bear consideration when the issue is finally settled in the Reference:

1. Delaying the commencement of the arbitration or refraining from granting interim reliefs for a defect relating non-payment or insufficient payment of stamp duty is certainly avoidable given that such defect is a curable defect under the Stamp Duty Law.
2. The legislature expressly recognises the universally accepted separability doctrine, in that an arbitration clause within a contract “*shall*” be treated as “*an agreement independent of the other terms of the contract*”; and that an arbitral tribunal’s decision that the contract is null and void “*shall not entail ipso jure the invalidity of the arbitration clause*”.¹⁶
3. The courts can treat the issue of non-payment or insufficient payment of stamp duty as an issue of jurisdiction which can be decided by the arbitral tribunal under Section 16 of the Arbitration Act.

¹⁴ (2021) 2 SCC 1, para 91(i)

¹⁵ AIR 2022 SC 797, para 23.

¹⁶ Sections 16(1)(a)-(b), Arbitration Act.

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4. The courts or the arbitral tribunal (as applicable) could make the enforceability of the final award conditional on payment of requisite stamp duty with applicable penalty on the relevant instrument.

Making India a hub for international arbitration will significantly develop the arbitration landscape in India thereby generating revenue for the State through alternate avenues; revenue generation being the principal objective of the Stamp Duty Law. Even though the directions of the Supreme Court in *NN Global* provide some comfort and an interim process, the decision in *Garware Wall Ropes* is likely to be the dominant view on the separability doctrine until the Reference is conclusively decided by the Supreme Court.

Parties to contracts under Indian law which also contain arbitration agreements should remain mindful of the stamping requirements in India and ensure that requisite stamp duty is paid for all their agreements governed by Indian law or where the arbitration is seated in India.

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