Disputes arising out of contractual obligations between parties, even if they involve issues of tax reimbursement or compliance, do not fall within the category of non-arbitrable disputes relating to sovereign functions, provided neither party is questioning the validity or legality of the levy of the tax itself

The **Allahabad High Court** in the case of **Shri Pramhans Enterprises vs Varanasi Aurangabad NH-2 Tollway Pvt Ltd [Arbitration and Conciliation Application u/s 11(4) No. - 129 of 2025] dated March 17, 2026**, has held that the disputes arising out of contractual obligations between parties, even if they involve issues of tax reimbursement or compliance, do not fall within the category of non-arbitrable disputes relating to sovereign functions, provided neither party is questioning the validity or legality of the levy of the tax itself.

Further, while exercising jurisdiction under Section 11 of the Arbitration and Conciliation Act, 1996, the Court is not required to go into the merits of the dispute; and the scope is strictly limited to examining the existence of an arbitration agreement and whether the dispute is prima facie arbitrable, added the High Court.

The Court observed that sovereign functions of the State, including taxation, being inalienable and non-delegable, are non-arbitrable. However, it is evident that disputes arising out of contractual obligations between parties, even if they involve issues of tax reimbursement or compliance, do not fall within the category of non-arbitrable disputes.

Reference was made to the decision of the Delhi High Court in *Spectrum Power Generation Limited vs. Gail (India) Limited [ARB.P. No. 746 of 2022]*, where it was held that where the issue does not relate to the taxing power of the State but rather whether GST/VAT liability could be passed on or reimbursed under an agreement, the dispute is arbitrable.

The Court noted that in the present case, neither party is questioning the validity or legality of the levy of GST. The dispute is essentially with regard to the payment of the contractual dues, which has been withheld by the respondents on the ground of alleged non-compliance of GST obligations by the applicant. The Court observed that such a dispute is contractual in nature and is, therefore, arbitrable. It is always open to the respondents to raise their defence or counterclaim before the arbitral tribunal with regard to GST compliance or any consequential liability.

Further, the Court observed that at this stage, while exercising jurisdiction under Section 11(4) of the Arbitration and Conciliation Act, it is not required to go into the merits of the dispute. Thus, referring to the case of Duro Felguera S.A. vs. Gangavaram Port Limited, the Court noted that the scope is limited to examining the existence of an arbitration agreement and whether the dispute is prima facie arbitrable, nothing more, nothing less.