

'DAMAGES' UNDER INDIAN CONTRACT LAW



'Damages' are monetary compensation payable by the defaulting party to the non-defaulting party for the loss suffered by it, due to breach of a contract. The primary aim of damages is to compensate the non-defaulting party, and to place it in the same position which it would have occupied had the breach of contract not occurred.

This primer covers the concept of 'damages' in India, with respect to breach of contract.

1. **What are the laws governing payment of damages for breach of contract in India?**

The Indian Contract Act, 1872 ("**Contract Act**") is the principal statute regulating Indian contract law and includes provisions relating to payment of damages for breach of contract.

2. **When are damages awarded to a contracting party?**

Damages may be awarded in case of a breach of contract i.e., when one of the parties to a contract fails or refuses to abide by the terms of the contract resulting in non-performance of its contractual obligations and such non-performance results in a loss to the non-defaulting party. Under the Contract Act, the non-defaulting party can seek damages from the defaulting party for this non-performance of the contract.

3. **What are the different types of damages under the Contract Act?**

The Contract Act provides for two types of damages viz, liquidated and unliquidated damages.

4. **What are liquidated damages?**

Liquidated damages are a pre-determined amount agreed between the contracting parties. The contracting parties agree that this pre-determined amount will be payable by the party breaching the contract to the counterparty as damages in the event of such breach of the contract.

5. What are unliquidated damages?

Unliquidated damages are those damages which are not specified in the contract. These may be awarded by the courts on an assessment of the loss or injury caused to the non-defaulting party due to the breach of contract by the defaulting party.

6. How can a party claim damages?

Generally, a non-defaulting party will be required to address a communication to the defaulting party and claim damages, whether liquidated or unliquidated. If the defaulting party fails to respond or contests the claim, the non-defaulting party will be required to approach the relevant court or arbitral tribunal (where the contract contains an arbitration clause).

7. What is the period of limitation for filing a suit of damages?

The period of limitation for a suit for damages in the court of law after a breach of contract is three years from the date the non-defaulting party becomes aware of the breach of the contract. Thus, if a non-defaulting party fails to file a suit or approach the arbitral tribunal within three years of being aware of the breach of contract, it may no longer have the right to seek damages against the defaulting party.

8. What are some necessary conditions for claiming damages?

The following conditions are essential for liquidated damages:

- a. Existence of a contract;
- b. There must be a breach of contract; and
- c. The breach must have resulted in actual damage or loss to the non-defaulting party.

A claim for liquidated damages stands on the same footing as a claim for unliquidated damages, and the defaulting party does not incur a pecuniary liability at the instance of default, nor does the injured party become entitled to claim a debt. The non-defaulting party is only entitled to sue for damages and have them adjudicated upon.





9. Can a non-defaulting party claim loss of profit as damages due to breach of the contract?

Indian courts have awarded loss of profit damages, if following two conditions are fulfilled:

- a. Natural consequence: the loss of profit must be a natural consequence of the breach of contract; or
- b. Parties' contemplation: the loss of profit must be one which the parties knew at the time of contracting to be likely to be a result of a breach.

10. Which party needs to provide evidence while claiming unliquidated damages?

In a claim of unliquidated damages, the non-defaulting party claiming damages has to prove the breach of contract and the loss suffered by it. The quantum of damages claimed must also be proved with reasonable certainty.

11. Which party needs to provide evidence while claiming liquidated damages?

In the claim of liquidated damages, the non-defaulting party claiming damages has to prove the breach of contract and show that the stipulated liquidated damages are a genuine estimation of the loss suffered by it because of the breach.

12. What is mitigation in case of contractual breach?

For an award of damages, it is necessary that the non-defaulting party claiming damages has taken reasonable steps to avoid such loss, and they cannot just let the situation worsen without taking any steps on their part to avoid such a breach or mitigate the losses if the breach is inevitable. What constitutes as 'reasonable' depends on the facts and circumstances of the given case.

13. Does the Contract Act have provisions to compute unliquidated damages?

No, the legal provisions in the Contract Act don't specifically provide the measure for computation of unliquidated damages. So, the courts compute damages based on the facts of each case, claims made and proved by the party, steps taken by the non-defaulting party to mitigate contractual breach, etc.

14. What are the guiding principles in Contract Act for computing liquidated damages?

Indian courts have laid down that the sum mentioned in the contract is payable as liquidated damages only if it is a 'genuine pre-estimate of damages'. Otherwise, the non-defaulting party is entitled to only reasonable compensation, not exceeding the fixed sum mentioned in the contract.

15. Can contracting parties limit the amount of damages payable for any breach of contract?

Yes, contracting parties may restrict liability for damages by adding express provisions in the contract stating that no compensation will be payable in the event of certain breaches or that the liability will be limited only to certain kinds of damages.

16. Can interest be levied on damages?

A court may, at its discretion, grant interest from the date of filing of the suit till the realization of the amount of damages to the non-defaulting party.

17. Will there be any income-tax implications on receipt of damages?

Receipt of damages pursuant to a contract may give rise to adverse income-tax implications. Damages received under a contract may be characterized as revenue receipts or capital receipts. Revenue receipts are generally receipts which arise in the ordinary course of business and will be taxable as business income in the hands of the recipient. On the other hand, capital receipts are those receipts which do not arise from the ordinary course of business and generally arise on account of loss of business or source of income. Such capital receipts, if not arising from transfer of a capital asset, may not be liable to tax in the hands of the recipient. Depending upon the nature of the receipt, withholding obligation may arise on the payer of damages. Thus, it would be relevant to determine the nature of the damages in order to evaluate the applicable income-tax implications and withholding tax implications.



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