



Notice Period Recovery – liable for GST?

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In recent years, the issue of Service Tax/GST liability on the Notice period recovery is a subject matter of dispute. While certain conservative employers have made a choice to pay service tax on such recoveries, certain employers have made bold choices of not paying taxes which were followed by the issuance of the demand notices/orders confirming the service tax demand by the Revenue department. The demands are agitated before various forums and very recently the Hon'ble HC of Madras delivered a decision holding that service tax is not liable on the Notice period recoveries. In this article, we have made an attempt to explain the Madras HC decision and its implication on service tax & GST liability on the Notice period recovery.

Background:

When an employee leaves an organization/ breaches the contract of total term employment, he is obligated to serve a tenure (as may be decided by the employer at the time of hiring in the terms of employment). This is termed as '**Notice period**'. It is a cushion for the employer to recruit a new employee to replace the outgoing employee, to smoothly transition. In case the employee does not serve the mandated notice period, the company can rightfully recover an amount which is popularly known as "**Notice period recovery**" as per terms of the employment contract.

The question of levy of service tax on such recoveries started after introduction of Negative list in the year 2012, wherein definition of 'service' u/s. 65B(44) of Finance Act, 1994 was wider covering almost everything with certain exclusions therein.

The Revenue department raised service tax demands across the country stating that the employer has tolerated the act of immediate quitting from service, by the employees and such toleration results in the rendition of service. For this, Revenue department is relying on the entry in '*declared service*' given u/s. 66E(e) of Finance Act, 1994 which reads as under:

"agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act."

The demands are agitated before appellate forums on various grounds.



Recent decisions under service tax

Recently, two interesting decisions are delivered holding that service tax is not liable on the Notice period recoveries. The decisions are

- **Hon'ble Madras HC decision** in case of **GE T & D India Ltd v. D.C.C.E, Chennai 2020-TIOL-183-HC-MAD-ST** wherein it was held that *"The employer cannot be said to have rendered any service per se much less a taxable service. He has merely facilitated the exit of the employee upon imposition of a cost upon him for the sudden exit, the definition in clause (e) of Section 66E is not to be attracted to this scenario as the employer has not 'tolerated' any act of the employee but has permitted a sudden exit upon being compensated by the employee in this regard."*
- **Hon'ble CESTAT, Allahabad** in case of **HCL Learning Limited v. CST 2019-TIOL-3545-CESTAT-ALL** wherein it was held that *"notice pay recovery is out of the salary already paid and we also note that salary is not covered by the provisions of service tax. Therefore, we set aside the impugned order and allow the appeal"*.

As there is a fair possibility that the Revenue department may approach Hon'ble Supreme court, we shall wait & see the verdict of the Hon'ble Apex court to put an end to this issue. Meanwhile, the above cited decisions would surely help to get away the service tax demands.

The legal position in the GST Regime & Impact of the above decisions:

A similar entry as that in Sec 66E(e), *ibid* also there in GST law vide Entry No. 5(e) of Schedule II to the definition of 'Supply' given u/s. 7 of CGST Act, 2017 as amended. Therefore, the rationale of the above decisions would equally applicable under GST also. Further, it gets weight from the retrospective amendment made in the definition of 'supply' u/s. 7, *ibid* to make the entries in Schedule II are only for classification purposes and *ipso facto* of entry in Sch. II would not make it as 'supply'. Hence, **it can be said that GST is not liable on the Notice period recoveries.**

Suggested course of action:

Status	The suggested course of action
For the past period	<ul style="list-style-type: none"> • If Service Tax/GST was not paid - Contest the demands, if arises • If Service Tax/GST was paid - Seek refund of the Service tax/GST paid subject to fulfillment of unjust enrichment (not collecting from the employee)
For the future period	<ul style="list-style-type: none"> • Pay GST under protest and inform the department with specific mention that refund would be sought in the future. <p style="text-align: center;">Or</p> <ul style="list-style-type: none"> • Contest the demands, as and when arises.



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