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TAX FLASH NEWS

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Notice pay recovery liable to GST at 18% – Gujarat AAR

The Authority for Advance Ruling, Gujarat (AAR) has recently held[1] that notice pay is a sum mutually agreed between the employer and the employee for breach of contract. It can be regarded as a consideration to the employer for 'tolerating the act' of the employee to not serve the notice period which was the employee's agreed contractual obligation.

Brief facts

The applicant had filed an application to seek ruling on whether it is liable to pay GST on recovery of Notice pay from the employees who are leaving the company without completing the notice period as specified in the appointment letter.

Contention of the applicant

The applicant contented that notice pay recovery are an adjustment of salary and hence does not tantamount to any supply which is chargeable to GST. The said contention was on the basis of the following –

a) Notice pay is a sum mutually agreed by employer and employee. It flows from the employment contract read with section 74 of the Indian Contract Act, 1872 and not under any other separate contract wherein the employer has agreed to refrain from doing any act against the concerned employee.

b) By virtue of the notice pay recovery stipulated in the contract an employer can only sue for recovery of such amount and it cannot mandatorily enforce serving of the notice period. Thus, the employer cannot be said to have refrained from an act of suing the employee for mandatory servicing against the notice pay recovery.

c) Notice pay recovery are deduction from the salary payable to the resigning employee, it is not a separate consideration flowing from any independent contract.

d) Applicant relied on the Madras High Court judgement[2] under the erstwhile service tax regime, where the court had held that 'notice pay' recovered by an employer is outside the scope of levy of service tax. Further, the applicant also relied on Allahabad CESTAT ruling[3] where the tribunal had held that when amounts are recovered out of salary already paid, such amounts would not be subject to service tax as salaries are not subject to tax.

Ruling by the Advance Authority

The AAR made the following observations

a) Clause 5(e) of schedule II of the Central Goods and Services Tax, 2017 ('CGST Act') prescribes that 'agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act' shall be treated as supply of service.

b) The condition to pay an amount as notice pay normally forms part of the terms and conditions of employment. This would mean that the employee has understood and accepted the condition, that in the contingency of his inability to provide the prescribed notice period, he can exercise the option of paying the notice pay as the consideration for the employer to agree to the obligation of letting him go, which the employer is bound to do.

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[1] Amneal Pharmaceuticals Pvt. Ltd. [Advance Ruling no. GUJ/GAAR/R/51/2020 dated 30 July 2020]

[2] GE T&D India Limited vs. Deputy Commissioner of Central Excise, Chennai [W.P. no. 35728 to 35734 of 2016, WMP. no. 30704 to 30710 of 2016]

[3] HCL Learning Limited vs. Commissioner of Central Goods and Service Tax, Noida [Service Tax Appeal no. 70580 of 2018]

c) On the case laws referred by the applicant, the AAR observed that the decision of the Madras High Court and the CESTAT relates to the disputes under the service tax regime and thus not applicable in the instant case involving levy of GST.

Based on the above observations, the AAR held that the applicant is liable to pay GST @ 18 per cent under the entry 'services not elsewhere classified', on the recovery of notice pay from the employees who are leaving.

Our comments

In yet another debatable issue of levy of GST on notice pay, the AAR had held in favour of the revenue. It is important to note here that under the erstwhile regime, the Madras High Court has held that the employer cannot be said to have rendered any service per se by facilitating the exit of the employee upon sudden exit. While, the AAR in the instant case has held that the decision of the High Court under the erstwhile regime shall not apply while determining the levy under GST.

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