

Madras HC: No service tax on payment received from employees for Notice Period

The Hon'ble HC, Madras in the matter of ***GE T & D India Limited v. Deputy Commissioner of Central Excise [W.P. Nos. 35728 to 35734 of 2016 and WMP. Nos. 30704 to 30710 of 2016 dated November 7, 2019]*** held that service tax is not leviable on the payment received by the Petitioner in lieu of notice period paid by the outgoing employees.

Facts:

GE T & D India Limited (“**the Petitioner**”) is a dealer assessed to service tax by the Department (“**Respondent**”). The terms of employment of the Petitioner include a stipulation for a notice period prior to quitting from employment, ranging from two to three months. An option is provided to the employees to the effect that if they are not in a position to stay and serve out the notice period, then in lieu of the same, the employee will be required to pay the equivalent pay of salary for the period for which notice was not served.

The Petitioner in this case had received certain amounts in lieu of notice period from outgoing employees. The Respondent was of the view that this amount would attract service tax since the petitioner is deemed to have facilitated the termination of employment and thus a category of service entitled and described as 'facilitation of termination of employment' was carved out by the Respondent.

Issue involved:

Whether service tax shall be leviable on the money received from employee in lieu of notice period.

Held:

The Hon'ble HC, Madras in ***W.P. Nos. 35728 to 35734 of 2016 and WMP. Nos. 30704 to 30710 of 2016 dated November 7, 2019*** held a under:

- The CBEC vide CBEC's Guidance Notes dated June 20, 2020 has answered in the negative, pointing out that such amounts would not be related to the rendition of service. Equally, the employer cannot be said to have rendered any service per se and 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 of the Finance Act, 1994 (“**the Finance Act**”) is not attracted 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.
- Though normally, a contract of employment qua an employer and employee has to be read as a whole, there are situations within a contract that constitute rendition of

service such as breach of a stipulation of non-compete. Notice pay, in lieu of sudden termination, however, does not give rise to the rendition of service either by the employer or the employee.

Our Comments:

In GST also, there is a provision similar to Section 66E (e) of the Finance Act i.e., Para 5(e) of Schedule II of the Central Goods and Services Act, 2017 ("**CGST Act**"):

"5. Supply of services

The following shall be treated as supply of services, namely:-

(e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act; and"

Section 7(1)(d) of the CGST Act which included items of Schedule II under the 'includes' portion of term 'supply', has been omitted retrospectively w.e.f. July 1, 2017, with insertion of Section 7(1A) which states that *"where certain activities or transactions constitute a supply in accordance with the provisions of sub-section (1), they shall be treated either as supply of goods or supply of services as referred to in Schedule II"*. Hence, reference of Schedule II is now restricted to only classification as supply of goods or services and chargeable to GST only if the activity/ transaction qualifies as supply in terms of Section 7(1) of the CGST Act.

Therefore, it can be argued that the payment received by the company in lieu of notice period will not be taxable under Para 5(e) of Schedule II of the CGST Act.

Relevant provisions:

Section 65B of the Finance Act:

"(44) "service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include-

(a) an activity which constitutes merely,--

(i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or

(ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of Article 366 of the Constitution; or

(iii) a transaction in money or actionable claim;

(b) a provision of service by an employee to the employer in the course of or in relation to his employment;

(c) fees taken in any Court or tribunal established under any law for the time being in force”

Section 66E(e) of the Finance Act:

“Declared services.

66E. The following shall constitute declared services, namely:—

(e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;”

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