

**No service tax payable on amount of notice pay recovered from employer in lieu of sudden termination of employees**

The CESTAT, Delhi in *M/s Rajasthan Rajya Vidhyut Prasaran Nigam Ltd. v. Commissioner of CGST, Customs [Service Tax Appeal No. 53020 of 2018 dated January 01, 2022]* set aside the order passed by the Revenue Department confirming demand of service tax on the notice pay recovered by the assessee from its employees for premature resignation. Held that, no service tax is payable on notice pay in lieu of sudden termination, as it does not give rise to the rendition of service either by the employer or the employee, and compensation for failure under a contract cannot be consideration for service. Further held that such contract cannot be termed as declared service.

**Facts:**

M/s Rajasthan Rajya Vidhyut Prasaran Nigam Ltd. (**“the Appellant” / “the Employer”**) is a public sector undertaking of the Government of Rajasthan and engaged in transmission of electricity. An audit took place by the Service Tax Department, and it was found that the Appellant did not discharge service tax of INR 28,10,698/- for the amount recovered from its employees on their premature resignation i.e. without giving the requisite notice period.

Thereafter, a Show Cause Notice (**“SCN”**) dated July 07, 2016 was issued demanding service tax amounting to INR 3,55,472 along with interest under Section 75 the Finance Act, 1994 (**“the Finance Act”**) and imposing penalty under Section 78 of the Finance Act.

Subsequently, the Assistant Commissioner passed Order in Original dated December 14, 2016 confirming the demand of service tax along with interest and penalty, which was further upheld vide Order-in-Appeal dated June 19, 2018 (**“the Impugned Order”**), by the Commissioner (Appeals) (**“the Respondent”**) and hence the Appellant has filed this petition.

The Respondent contended that, the Appellant had an agreement to tolerate a situation i.e. employees resignation without the requisite notice period in return for a consideration and therefore, the amounts received or recovered from its employees is exigible to service tax under Section 66E(e) of the Finance Act and such liquidated damages as a penalty for resigning without notice period is built into the employment contract.

**Issue:**

Whether the amounts received or recovered by the Employer from its employees for resigning from the service without giving the requisite notice is exigible to service tax?

**Held:**

The CESTAT, Delhi in ***Service Tax Appeal No. 53020 of 2018 dated January 01, 2022*** held as under:

- Noted that, service was leviable under Section 66B of the Finance Act on all services, other than those included in the negative list. Service was defined to mean any service carried out for a consideration and included 'declared services' under section 66E of the Finance Act and it further includes, 'agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act'.
- Observed that, declared service becomes exigible to service tax if it is done for a consideration and the Respondent has confused compensation for consideration. While a consideration is something received for performance under the contract, compensation is received if the other party reneges or fails to perform as per the contract. Consideration is the object of the contract and compensation is not.
- Further observed that, consideration is the result of successful performance of the contract while compensation is paid by the party frustrating the contract to the other.

Compensation is also paid, if the contract so provides, when one party performs under the contract but not within the conditions laid down, such as delays in performance.

- Denied with the contention of the Respondent and distinguished contract from agreement and stated that what falls within the ambit of Section 66E(e) of the Finance Act are cases where the essence of the agreement, is tolerating a situation or refraining from an act in return for a consideration and if the agreement is for something else and if one of the parties fails to perform as per the agreement and pays to the other a compensation as pre-decided in the agreement, it does not fall under Section 66E(e).
- Opined that, the matter is about an employment contract between the employee and the notice period and the compensation are incorporated in the employment contract itself, but these are not the purpose of the contract and therefore, any compensation paid towards the same is not a consideration for the contract.
- Relied on the judgment of the Hon'ble Madras High Court in ***Ge T & D India Limited v. Deputy Commissioner of Central Excise [W.P. No. 26292 of 2018 dated December 13, 2019]*** wherein it was held that, no service tax is payable on notice pay in lieu of sudden termination, as it does not give rise to the rendition of service either by the Employer or the employee.
- Set aside the Impugned Order.
- Held that, any compensation paid towards the failure under a contract cannot be consideration for service under the contract.

**Our comments:**

**Under GST regime:**

Recently, the AAAR, Madhya Pradesh in ***M/S. Bharat Oman Refineries Limited [Advance Ruling No. MP/AAAR/07/2021 dated November 8, 2021]*** reversed the ruling passed by

the AAR and held that merely because the employer is being compensated does not mean that any services have been provided by him or that he has 'tolerated' any act of the employee for premature exit.

**Under Service Tax regime:**

In the service tax regime, the Hon'ble Madras High Court in ***Ge T & D India Limited v. Deputy Commissioner of Central Excise [W.P. No. 26292 of 2018 dated December 13, 2019]*** in a similar case has held that no service tax is payable on notice pay. Relevant portion is reproduced below:

*"The employer cannot be said to have rendered any service per se much less a taxable service 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 as extracted above is not attracted to the scenario before me as, in my considered view, 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.*

*.....Notice pay, in lieu of sudden termination however, does not give rise to the rendition of service either by the employer or the employee."*

**Relevant Provision:**

**Section 65B(22) of the Finance Act:**

*"Interpretations.*

*'65B. In this chapter, unless the context otherwise requires,--*

*(22) "declared service" means any activity carried out by a person for another person for consideration and declared as such under section 66E;"*

**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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