

GUJARAT AUTHORITY FOR ADVANCE RULING, GOODS AND SERVICES TAX, A/5, RAJYA KAR BHAVAN, ASHRAM ROAD, AHMEDABAD – 380 009.	
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ADVANCE RULING NO. GUJ/GAAR/R/51/2020
 (IN APPLICATION NO. Advance Ruling/SGST&CGST/2019/AR/18)

Date: 30.07.2020

Name and address of the applicant	:	M/s Anneal Pharmaceuticals Pvt. Ltd., 882/1-871, Ground Floor, Near Hotel Karnavati, Sarkhej-Bavla Highway, Village- Rajoda Bavla, Ahmedabad 382220 (Gujarat).
GSTIN of the applicant	:	24AAGCA0781K1ZP
Date of application	:	05.03.2019
Clause(s) of Section 97(2) of CGST / GGST Act, 2017, under which the question(s) raised.	:	<i>(g) Whether any particular thing done by the applicant with respect to any goods and/or services or both amounts to or results in a supply of goods and/or services, within the meaning of that term?</i>
Date of Personal Hearing	:	09.07.2020
Present for the applicant	:	Shri Satyajit D Naik

BRIEF FACTS

The applicant submitted that they are a 100% Export Oriented Unit (EOU) engaged in the manufacturing of pharmaceuticals products. They, at the time of appointing any employee at their factory situated at 882/1-871, Ground Floor, Near Hotel Karnavati, Sarkhej-Bavla Highway, Village-Rajoda Bavla, Ahmedabad-382220 (Gujarat), are entering into contract with employees by issuing “Appointment Letter”. Under appointment letter, it has been clearly mentioned that, either parties shall serve a three months mandatory notice to terminate this contract. Thus, three months’ notice is mandatory for all employees/employer. In case, if any employee doesn’t serve the notice period after tendering the resignation, then as per contract (Appointment Letter) condition, company is entitled to recover the notice pay from the agreed portion of salary to compensate the loss to company. The condition is hereby reproduced below:

“Your services can be terminated by giving three months’ notice or notice pay in lieu of notice period from either side.”.

2. Therefore, by virtue of the aforesaid condition, in case employer decides to terminate services of any employee without notice period, is obliged to pay the notice period salary to the employee to enable him to sustain himself till he finds suitable employment.

3. In case the employer signs and leaves without serving the notice period, the company is deducting the notice pay amount for unserved notice period to cover the loss of company for immediate recruitment of new candidates and also to regularize the activities not handed over to upcoming employee.

4. In their view, the notice period amount recovered/paid from/by the employee/employer should not be under the purview of GST since its arrangement to compensate the loss to employer/employee their losses as per contractual arrangement.

5. In above backdrops, the applicant sought for advance ruling in respect of following question:

Whether the applicant 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 issued as per the contract entered between Employer and the Employee?

6. Statement containing the applicant's interpretation of law and/or facts, as the case may be, in respect of aforesaid question:

6.1 The applicant submitted that the Notice pay recovery is nothing but the amount stipulated in the employment contract for breach in serving the stipulated notice period. Since notice pay is a sum mutually agreed by the parties for breach of contract it can be regarded as a consideration flowing from the employment contract itself read with Section 74 of the Indian Contract Act, 1872 and not under any other separate contract wherein employer has agreed to refrain from doing any act against the concerned employee.

6.2 Once notice pay recovery is stipulated in the contract an employer can only sue for recovery of such amount but cannot enforce mandatory serving of the notice period. Once it is concluded that an employee cannot enforce mandatory serving of the notice period, such employer cannot be said to have refrained from an act of suing the employee for mandatory serving against the notice pay recovery.

6.3 In such scenario, notice pay recovered cannot be said to be a consideration against agreeing to the obligation to refrain from an act, or to tolerate an act.

6.4 They further stated that Entry No. 1 of Schedule III to the CGST Act, 2017 provides that “*services by an employee to the employer in the course of or in relation to his employment shall not be regarded as supply of goods or supply of services.*” Notice pay recovery is nothing but a deduction from the salary payable to the resigning employee. It is not a separate consideration flowing from any independent contact and the employee is relieved from the services and issued a relieving letter only once the terms of employment agreement (Appointment Letter) are fulfilled. Hence, it should be covered within the referred entry.

6.5 In the context of Income Tax, an issue with respect to claim of deduction for notice pay came up before Hon. Ahmedabad Tribunal in the case of ***Nandinho Rebello v. Deputy Commissioner of Income Tax (2017) 80 taxmann.com 297 (Ahmedabad-Trib.)***. In this case, notice pay was claimed in the return of income as deduction which was recovered from the salary by assessee’s previous employers as mentioned above. *The Hon’ble Tribunal found that **this is a case of recovery of the salary which is already made to the assessee** for which they have not to refer Section 16 of the Act as mentioned by the Ld. CIT (A). It is pertinent to note that the assessee has actually received the salary from his previous employers after deducting the notice period as per the job agreement with them. Therefore, in Tribunal’s considered view, the actual salary received by the assessee is only taxable and, therefore, Tribunal allow this ground of appeal of the assessee.*

6.6 The applicant further stated that above ruling clearly support the view that notice pay recovery is nothing but an adjustment of salary and, hence, does not tantamount to any supply which is chargeable to GST.

7. At the time of personal hearing held through Video Conferencing on 09.07.2020, the Authorised Representative of the applicant, Shri Satyajit D Naik reiterated the facts as stated in the Application.

7.1 Further, the applicant via email dated 15.07.2020 stated that they relied upon the Madras High Court Order dated 13th December, 2019 wherein it was held that “notice pay” recovered by an employer from its employees in lieu of the employees serving their required employment termination notice period is outside the scope of service tax. Service tax was an indirect tax charged in

India on the provision of taxable services from July 1994 until 30 June 2017, at rates ranging from 12% to 15%. It was one of a number of indirect taxes replaced by goods and services tax (GST) as from 1 July 2017. Copy of Judgment is attached herewith. Further, they have also referred the case law of M/s. Gujarat State Fertilizers & Chemical Ltd (2016) wherein it was held that *the cessation of employment should also be treated as employment service not liable for service tax*. They also referred the decision of Allahabad CESTAT in case of M/s. HCL Learning Systems Vs CCE, Noida (service tax appeal no. 70580 of 2018) *wherein it has been held (in November 2019) 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*. In view of the above, they viewed that payment of GST on recovery of notice pay does not have merit and accordingly, they requested to pass appropriate order.

DISCUSSION & FINDINGS:

8. We have considered the submissions made by the applicant in their application for advance ruling as well as at the time of personal hearing. We also considered the issue involved, on which advance ruling is sought by the applicant, relevant facts & the applicant's interpretation of law.

8.1 At the outset, we would like to state that the provisions of both the CGST Act and the GGST Act are the same except for certain provisions. Therefore, unless a mention is specifically made to such dissimilar provisions, a reference to the CGST Act would also mean a reference to the same provisions under the GGST Act.

9. In this case, a moot point is to be decided is whether the applicant 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 issued as per the contract entered between them.

10. The applicant has submitted that at the time of appointing any employee at their factory, they are entering into contract with employees by issuing "Appointment Letter". Under appointment letter, it has been clearly mentioned that, either parties shall serve a three months' mandatory notice to terminate this contract. Thus, three months' notice is mandatory for all employees/employer. In case, if any employee doesn't serve the notice period after tendering the resignation, then as per contract (Appointment Letter) condition, company is entitled to recover the notice pay from the agreed portion of salary to compensate the loss to company. The condition is hereby

reproduced below:

“Your services can be terminated by giving three months’ notice or notice pay in lieu of notice period from either side.”.

10.1 Employees who resign from their job are expected to serve notice period as mentioned in the appointment letter i.e. three months. If the employee does not serve such notice period, the salary of the unserved portion of notice period is retained by the employer, which is called as “Notice Pay Recovery”.

11. We find that said Notice Pay is nothing but the amount stipulated in the employment contract for breach in serving (not serving) the stipulated notice period. In other words, 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.

12. We further note that GST is applicable on supply of taxable goods or services. Section 7(1) of the CGST Act, 2017, includes activities referred to in Schedule II in the scope of supply. **Clause 5(e) to Schedule II to CGST Act 2017**, declares 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. The condition to pay an amount as notice pay in lieu of notice period, for the employer to agree to let go an employee, normally forms part of the terms and conditions of employment. This would mean that the employee while accepting the offer of employment, has not only understood the intent on the part of the employer in prescribing this exit condition, but has also accepted it. In other words, 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 as it is part of the terms and conditions already agreed to and settled between them. In our view, therefore, this transaction of the employer agreeing to the obligation of tolerating an act (quitting without any advance notice) on the part of the employee, for payment of a sum (notice pay), will be covered under **Clause 5(e) to Schedule II to CGST Act 2017**, as a declared service.

13. We have perused the Case Law of the Madras High Court in the case of *GE T&D India Limited v. Deputy Commissioner of Central Excise, Chennai*,

reported in 2020-VIL-39-Mad-ST as quoted by the applicant and we find that in this case, the authorities demanded service tax on the amount of notice pay recovered by taxpayer from its employee's salary. The Madras Court hold as under:

“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.

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.”

Further, we have also perused the case law of M/s. Gujarat State Fertilizers & Chemical Ltd (2016), wherein it was held that *the cessation of employment should also be treated as employment service not liable for service tax*. Further, we have also perused the decision of Allahabad CESTAT in the case of M/s. HCL Learning Systems Vs CCE, Noida (service tax appeal no. 70580 of 2018) *wherein it has been held (in November 2019) 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.*

From the above discussion, it is clear that above decisions relate to the disputes of Service Tax Regime. Hence, these rulings are not applicable to the present case, involving advance ruling in respect of levy of GST.

14. In view of the above, we hold that the applicant is liable to pay GST @ 18% under the entry of “services not elsewhere classified, on recovery of Notice Pay from the employees who are leaving the company without completing the notice period as specified in the Appointment Letter issued as per the contract entered between them.

15. In the light of the aforesaid circumstances, we rule as under.

R U L I N G

Question: Whether the applicant 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 issued as per the contract entered between Employer and the Employee?

Answer: Answered in the Affirmative, as discussed above.

(SANJAY SAXENA)
MEMBER

(MOHIT AGRAWAL)
MEMBER

Place: Ahmedabad

Date: 30.07.2020.