

## **Levy of GST on notice period recovery?**

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In GST regime, the number of exemptions / concessions have been brought down. A lot of effort has been put in drafting GST law and lot of litigated aspects are put to rest. However, there are still aspects like compensatory damages, employee notice period recovery which needs clarity as to taxation. In many private organisations, employees would be legally bound to serve for specified period which could vary from 1 month to 3 months depending on designation or role of a particular employee during termination of employment contract. If employee fails, then the security amount collected during appointment or amount which could be part of salary would be withheld by the organisation as 'Notice period pay'. The question of levy of tax on such income started after introduction of negative list concept in service tax. Though GST has replaced the law, the clarity on taxation of such notice period pay continues.

Certain activities have been specifically mentioned in Schedule II to CGST Act 2017 to be treated as goods or services. Agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act has been specifically stated to be treated a service in this schedule. By plain reading of the entry, it could be contended that notice period pay is the consideration received by employer for tolerating the act of employee who does not serve the notice period.

It is very interesting to note that UK VAT law which is very close to our new GST law does not levy tax on termination of contract subject to condition that the contract originally contains a clause allowing the parties to terminate early in lieu of compensation for losses arising from termination. However, levy could get attracted where no such clause exists in original agreement, and separate agreement reached to terminate. This may not be applicable in India as our GST law does not provide for such exemption.

### ***Employment services exempted from GST***

Services by an employee to employer in course of or in relation to employment would not be treated as either supply of goods or as services. There is a school of thought among few professionals that notice period pay is recovered in course of employment and should not be treated as supply liable for GST. It is important to note here that the services are provided by employer to employee by way of tolerating the act. Therefore, this view may not hold good for the simple reason that the exemption is for services by employee to employer and not for services by employer to employee. Safer way would be to pay GST on notice pay.

### ***Clarification from department in earlier law***

Tolerating of an act was considered as 'declared service' in earlier service tax law after introduction of negative list taxation system in the year 2012. After this, there were lot of queries raised on taxation of notice pay. The Director General of Central Excise Intelligence (DGCEI) in November 2015 had the following observation while conducting an audit of an assessee:

1. The activity of entering into an agreement by employer with employee to allow him to forfeit the security deposit or paying some charges/expenses/fee etc., in case of his leaving the employment without giving stipulated notice or completing the bond period, appears to be covered under the declared services of, "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act".

2. These services are being provided by the employers to its employees and consideration in terms of forfeiture of security deposit or other payments is being received by the employers in lieu of these services. Hence, Service Tax would be leviable on employers for providing these services.

### **Time of supply for the service**

Time of supply of services to be determined for services in terms of Section 13 of CGST Act 2017 which would be earliest of following:

- (a) Date issue of invoice by supplier, if invoice is issued within prescribed period (30 days) under Section 31(2) or date of receipt of payment, whichever is earlier; or
- (b) Date of provision of service, if invoice not issued within prescribed period or date of receipt of payment, whichever is earlier; or
- (c) Date on which recipient shows receipt of services in books of account

Issue of invoice in case of notice pay recovery is not common. If the amounts are recovered at the time of appointment, then date of receipt of such amounts is time of supply. Otherwise, the date of breach of contract could be considered as date of provision of service to determine time of supply.

### **Valuation of services**

If employers opt to pay GST on notice pay, then the issue to be brought to the notice of employees in terms of contract. GST at 18% could be added extra to the amount or the total amount could be treated as inclusive of 18% GST in terms of Rule 35 of CGST Rules 2017 if employer does not wish to add to burden of employees. One of the common error noticed in service tax regime was claiming back the tax amount paid on notice pay as Cenvat credit treating it as reverse charge payment. Such tax payment was being made without utilising the

available credit. This is not right as the amount recovered as notice pay would be treated as output supply of service.

***ITC utilisation for payment of tax***

For payment of GST on notice period recovery, tax payer could utilise the input tax credit balance, if any, as such recovery could be treated as output service.

***GST on payment made to employees on termination***

Conversely to recovery of notice pay, there could be instances wherein organisations pay amounts to employee for termination of employment contract. Such amounts paid would be “part of salary” and paid as salary. In such cases, there may not be disputes with regard to GST applicability.

**Conclusion:** Terms like ‘refrain’, ‘tolerate’ etc., needs clarity as these words leading to lot of interpretations and disputes. Employers who opt not pay GST on notice pay recovery run the risk. Therefore, paying GST taking a conservative view is a safer option. The aspects discussed above are limited to notice pay recovery from employees only. The analogy cannot be applied for liquidated damages, compensation for losses etc. as it is.

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