

## Is Service tax payable on notice period recovery?

- CA Mahadev.R

In some of the organisations, the employees are legally bound to serve for specified period (varying from 1 to 3 months) once they wish to leave the organisation. In case of failure to serve the specified period, the security amount collected at the time of appointment or amount which could be part of salary would be withheld by the organisation as 'Notice period recovery'. There was no levy of service tax on such amounts till introduction of 'Declared service' concept. From July 2012, after introduction of declared service concept, there have been different views expressed with regard to service tax applicability. In this article, we have tried to analyse the service tax implication on notice period recovery its converse as well as possible solution.

Under the negative list regime, agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act shall constitute a 'declared service' as per Section 66E (e) of Finance Act 1994. Accordingly, such service would be liable for service tax subject to provisions of place of provision of service. When the employee leaves the organisation without serving the stipulated notice period, then such activity of toleration of an act by the employer could be considered as 'declared service' liable for service tax.

One could argue that the services are in relation to employment and excluded from service definition. However, it is important to note that what is excluded from service definition is provision of service by an employee to employer and not otherwise. In case of 'notice period recovery', the tolerance of act is the service provided by employer to employee and therefore, the same may not be covered under the exclusion part.

### ***Recent clarification from department***

Recently, the Director General of Central Excise Intelligence (DGCEI) has held the following with regard to security amounts forfeited by a company for not serving notice period:

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.*

DGCEI has also communicated this to all Chief Commissioners for taking necessary action in similar cases in December 2015. Therefore, the employers collecting amounts as notice period recovery may be asked to discharge service tax.

### ***Point of taxation for the service***

The point of taxation (POT) for the services provided would be determined as per Rule 3 of POT Rules 2011 as below:

(a) Time when the invoice for the service provided or agreed to be provided is issued if invoice issued within 30 days. Otherwise, POT shall be date of such completion of provision of the service.

(b) If payment is received before the time specified in clause (a), the time, when he receives such payment would be the POT.

In case of 'notice period recovery', it would be difficult to imagine issuing of invoice for the service provided. In case any amounts are recovered at the time of appointment, then it could be held that the date of receipt of such amounts is the point of taxation as such amounts are received for the services (tolerating the act) agreed to be provided. In case, payments are not received the date of breach of contract could be considered as completion of provision of service and point of taxation.

### ***Value of service and determining the tax***

It may be impracticable to issue invoice and collect service tax by the employer from employees breaching the contract terms. Therefore, the best approach could be to have a clause in the employment agreement about the service tax applicability on the forfeiture amount. This could inclusive in which case the tax would be out of pocket for the company. It could also be exclusive in which case tax would be out of pocket for the outgoing employee.

### ***Cenvat credit utilisation for payment of tax***

For the purpose of payment of service tax on notice period recovery, the assessee would be eligible to utilise the Cenvat credit available if any as such recovery could be treated as output service.

### **Converse Situation**

In few companies, in the event of firing an employee, the companies may opt to pay additional notice period salary and ask employee to leave immediately. Such additional amount paid would be “part of salary” and paid as salary. In such cases, there may not be disputes with regard to service tax applicability.

### ***Registration amendment and disclosure in return***

As there is no specific category for the service discussed, the assessee would be required to get registration (amendment if already registered) under the head ‘*Other taxable services [services other than the 119 listed services]*’ for payment of service tax. The tax payments need to be appropriately disclosed in the periodical return to be filed in form ST-3 which would be helpful in claiming refunds when paid under protest.

**Conclusion:** The key terms in declared services such as ‘refrain’, ‘tolerate’ etc., needs clarity as these words leading to lot of interpretations and disputes. Employers who collect various amounts from employees such as Notice pay, canteen expenses, travelling expenses, etc, are not clear about the service tax implication. Therefore, a detailed clarification on these kinds of transactions from CBEC is need of the hour. Looking at GST, which may be ushered in April 2017, such exclusions / exemptions may not exists. However, for the time being it would be ideal for the assesses to pay service tax under protest on notice period recovery with intimation to department. If in future it is held that the service tax is not payable, the refund of such tax paid under protest can be claimed.

Authors could be reached at [mahadev@hiregange](mailto:mahadev@hiregange) for any further clarifications or suggestions.

-This article has been uploaded in KSCAA journal in the month of February 2016.