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Deduction of notice pay is recovery of salary at source and not application of income, hence deductible, says Ahmedabad Tribunal

Issue no: GES/14/2017

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Facts

- Nandinho Rebello ("the tax payer"), a salaried individual, worked with three employers and received salary as follows in the year 2009-10:

Employer	Period	Salary received in INR	Notice period pay recovered in INR
Reliance Communication Ltd	01.04.2009 to 09.05.2009	164,636	110,550
Sistema Shyam Teleservices Ltd	18.05.2009 to 24.02.2010	13,95,880	166,194
Videocon Tele Communication Ltd	03.03.2010 to 31.03.2010	5,46,060	

- He also received INR 23,310 as interest from Reliance Infocom Ltd. Employees' Provident fund (PF account). This was considered as exempt by the tax payer.
- In the tax return for the said year, the tax payer claimed deduction for INR 276,744/- (notice period pay recovered from his previous employers) and reported the net salary to tax.
- The Assessing Officer ("AO") added the entire salary income received from other two employers as part of taxable income.
- Aggrieved by this order, the tax payer filed an appeal before the Commissioner of Income-Tax (Appeals) ("CIT (A)") wherein he relied on the Bombay High Court decision (Ramchandra Dhonde Datar v. CIT) wherein it was held that termination payment could not be held solely as compensation for loss of employment and considered the notice pay recovery as non-taxable.
- The CIT (A) confirmed the additions made by the AO on the basis that Section 16 of the Act provides deduction only for prescribed items like entertainment allowance and taxes on profession and not for notice period pay recovery.
- The CIT (A) also held that the deduction of notice pay was primarily an application of income, after the salary has become due and hence cannot be claimed as deduction from taxable income. The CIT (A) relied on the Madras High Court decision in the case of CIT v. P. Natraja Shastri in which it was held that when remuneration has already accrued to assessee and it was waived, it has to be offered to tax.
- Aggrieved by the CIT (A)'s order, the tax payer filed an appeal before the Income-Tax Appellate Tribunal, Ahmedabad ("the Tribunal").

Issues before the Tribunal

- Whether salary recovered by the employer for not serving notice period can be claimed as deduction from salary income?
- Whether addition made by the AO and sustained by the CIT (A) in respect of interest income received from PF account, was correct?

Ruling of the Tribunal

- This is a case of recovery of salary for which reference to section 16 is not required;
- The tax payer has actually received salary net of notice period pay as per the employment agreement. Hence the actual salary received by the tax payer (salary net of notice period pay) only is taxable;
- The claim for deduction of notice period pay is allowed;
- With respect to interest income, during assessment proceedings, the tax payer had accepted the interest income from bank while that from the PF account remained undisclosed in the return of income. Hence, the addition made by the AO is sustained.

Comments

This is a welcome decision wherein the Tribunal concluded that notice pay deducted from salary cannot be deemed to accrue to the tax payer and hence is deductible. The Tribunal has adopted the view that this is a recovery and not an application of income. Companies may choose to review their positions on tax withholding, where notice pay recovery is involved, to optimize on the tax cost to their employees.

Source:

Nandinho Rebello v. Deputy Commissioner of Income-tax, Circle-14, Ahmedabad [2017] 80 taxmann.com 297 (Ahmedabad - Trib.)

References in the above decision:

Bombay High Court in the case of Ramchandra Dhonde Datar v. CIT[1961] 43 ITR 22 (Bom).

Madras High Court in the case of CIT v. P. Natraja Shastri[1976] 104 ITR 295

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