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Madras High Court holds notice pay recovery being outside the scope of levy of service tax

Service tax not applicable on notice pay recovery made by employer from employees.

The Madras High Court, while disposing the writ petition filed by GE T&D India Limited¹ (writ petitioner), has held that notice pay recovery made by an employer from its employees is outside the scope of levy of service tax.

Facts of the case:

- Employment agreements of the writ petitioner provides for serving a notice period of 2-3 months before quitting employment.
- In case an employee desires to quit employment before serving the notice period then the said employee is required to pay the equivalent salary for not serving the notice period.
- The petitioner had received certain amounts in lieu of notice period not served by the outgoing employees.
- The service tax authorities had issued show cause notices in relation to notice pay recovered by the employers from the employees.
- The authorities were of the view that such recovery was covered within the scope of "declared services" defined in clause (e) of Section 66E of Chapter V of Finance Act, 1994 and that the employer was "*tolerating an act*" of immediate quitting from service, by the employees and such agreement/ toleration results in the rendition of a taxable service.

Ruling:

- The Madras High Court observed that the employer cannot be said to have rendered any "service" and has merely facilitated the exit of the employee upon imposition of a cost upon him for the sudden exit.
- The definition of "declared service" is not attracted to this scenario as the employer has not "tolerated any act" of the employee but has permitted a sudden exit upon being compensated by the employee.
- For chargeability of service tax on notice pay recovery, contract of employment has to be read as a whole. There are situations in a contract that constitute rendition of service such as breach of a stipulation of non-compete. However, in case of notice pay (in lieu of sudden termination) rendition of service does not arise either by the employer or by the employee. Accordingly, service tax shall not be applicable of notice pay recovery.

¹ W.P.Nos.35728 to 35734 of 2016

Our comments:

This judgement brings relief to companies receiving notices from the authorities demanding service tax on notice pay recovery. It is pertinent to note that the CESTAT, Allahabad² had also adopted a similar view while quashing the demand raised on such notice pay recovery.

Under the GST regime, businesses should analyse the applicability of GST on notice pay recovery in light of the provisions of GST law and judicial pronouncements under service tax along with the relevant terms of the employment contracts.

² HCL Learning Limited vs. Commissioner of Central Goods and Service Tax, Noida Service Tax Appeal No. 70580 of 2018



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