

GST ON NOTICE PERIOD RECOVERY



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Meaning ?

- In many private organizations, employees would be legally bound to serve for specified period which could vary from 1 month to 3 months depending on termination.
- If employee fails, then the security amount collected during appointment or amount which could be part of salary would be withheld by the organization as 'Notice period pay'.

Extracts of section 7 prior to CGST (Amend.) Act, 2018.

- 7. (1) For the purposes of this Act, the expression “supply” includes--
 - (a).....;
 - (b).....;
 - (c).....; and
 - (d) The activities to be treated as supply of goods or supply of services as referred to in Schedule II.
- Accordingly, certain transactions were coming within ambit of supply merely by virtue of reference of Schedule II in the definition of “supply”.
- *One among them*-“agreeing to obligation to refrain from an act or to tolerate an act or a situation or to do an act”.

Extracts of section 7 post to CGST (Amend.) Act, 2018.

(1) For the purposes of this Act, the expression “supply” includes--

(a).....;

(b).....; [and]

(c).....; and

(d) The activities to be treated as supply of goods or supply of services as referred to in Schedule II.

[(1A) where certain activities or transactions constitute a supply in accordance with the provisions of sub-section (1), they shall be treated either as supply of goods or supply of services as referred to in Schedule II.];

The amendment has rectified the anomaly by providing that merely coverage of a transaction in Schedule II will not make it supply.

Notice pay under service tax era

- "Service" means any activity carried out by a person for another for consideration, and includes a **declared service**.
- The declared service entry had specifically included the below entry:
Agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act.
- Pre amendment under GST- similar interpretation to the levy of GST on the Notice Pay recovery as entries of Schedule II were covered within ambit of supply.
- ***However now it depends upon the test of supply?***

Test- Notice pay amounts to supply?

- No positive act of supply of service by company.
- It is merely recovery of compensation from the employees on account of their failure to fulfil the terms of contract/appointment and tantamount to be liquidated damages.
- The payment of damages is a condition of contract-Not a contract per se.
(Not a consideration for any service in the nature of forbearance or tolerating an act)
- **‘to tolerate an act’** relates to situations where a person commissions another person to do or commit a particular act for a consideration.

Section 74 of the Indian Contract

- *When a **contract has been broken**, if a sum is named in the contract as the amount to be paid in case of **such breach**, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract **reasonable compensation** not exceeding the amount so named or, as the case may be, the penalty stipulated for.*
- That, in terms of Section 74 *ibid*, it is explicitly clear that, the amount a party ('receiver') is eligible to receive upon the breaking of a contract **is in the nature of compensation** for breach.
- The term breach implies an act on part of the one breaching the contract ('the defaulter'), the breach doesn't therefore implies that the receiver is doing an act or tolerating an act.
- There is no supply element when the receiver is getting compensated owing to an act of the defaulter.
- **UK VAT law** where tax is not levied 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.

Allahabad CESTAT: HCL Learnings

- “notice pay recovery is out of the **salary already paid** and we also note that **salary is not covered by the provisions of service tax**. Therefore, we set aside the impugned order and allow the appeal”.
- Schedule III- Employer employee relationship- salary does not have any implications under GST law also.

THANK YOU

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For any clarification

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