Refund of GST Paid on Notice Pay Recovery – Way Forward

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Background:

A practice that is prevalent in organisations is of employees resigning from their employment without providing due notice to their employers and without proper handover. As a consequence of this practice, organisations have introduced a clause in the employment agreement, for forfeiture of salary amount in the event of the employee leaving the employment before the minimum agreed period, also known as Notice Pay Recovery (**"Notice Pay Recovery"**).

The concept of Notice Pay Recovery primarily emerges from the Shops & Establishments Act (relevant for each state) and the Payment of Wages Act, 1936 and rules made thereunder. For instance, the Payment of Wages Rules[1], does not allow deduction for breach of contract from the wages of any employed person unless there is a provision in writing, forming part of the terms of the contract of employment, requiring the employee to give notice on the termination of such employment.

In light of the aforementioned, the present article discusses the taxability of Notice Pay Recovery, which under the erstwhile Service tax regime and the present Goods and Services Tax (**"GST"**) regime had been a matter of unending dispute between the taxpayers and revenue authorities, until recently, when the Central Board of Indirect Taxes & Customs (**"CBIC"**) clarified vide Circular No. 178/10/2022-GST dated 03rd August, 2022 (**"Circular"**) that GST is not leviable on Notice Pay Recovery.

This article further discusses the findings of Hon'ble Kerala High Court in the recent ruling of Manappuram Finance Ltd vs Assistant Commissioner, Central Tax and Excise dated 12 December 2022, in relation to grant of refund of GST paid on Notice Pay Recovery and the ideal way forward for taxpayers.

controversy on Levy of Tax on Notice Pay Recovery prior to 03rd August, 2022:

An employer and employee are considered as 'related persons' pursuant to the definition of related persons under Central Goods and Services Tax Act, 2017 (**"CGST Act"**). Under the relevant provisions of the CGST Act and rules made thereunder, the transaction value of the supply of goods or services or both between related persons are determined in terms of specific valuation rules. However, in case of transactions between an employer and employee, which generally is in relation to the services by an

employee to the employer in the course of or in relation to his employment, 'salary' is the consideration for such services and is not treated as 'supply of services' in terms of entry 1 to Schedule III of the CGST Act. Thus, 'salary' paid by the employer to employee is specifically out of the purview of GST.

While there is no GST levied on 'salary', over the years doubts have persisted on the taxability of Notice Pay Recovery, which is a component of salary. The ambiguity is whether the amount of forfeiture of salary by the employer in the event of the employee leaving the employment before the minimum agreed period, can be classified within the scope of ***"Agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act"*** . The said provision under the erstwhile Service tax regime was stipulated under Section 66E(e) of the Finance Act, 1994 (Declared Services) and is pari materia to entry 5(e) under Schedule II of the CGST Act.

In order to understand the above issue more specifically, reference is made to the various decisions and rulings of the Hon'ble High Courts, Hon'ble CESTAT, Appellate Authority for Advance Rulings (**"AAAR"**) and Authority for Advance Rulings (**"AAR"**) which have provided conflicting views on the taxability of Notice Pay Recovery, discussed herewith:

Rulings under the erstwhile Service tax regime

The Hon'ble Madras High Court in **GE T AND D India Ltd vs Deputy Commissioner of Central Excise**[2] held that, notice pay, in lieu of sudden termination, does not give rise to the rendition of service either by the employer or employee and thus Section 66E(e) of the Finance Act, 1994 does not trigger. In similar vein, the Hon'ble CESTAT – Allahabad Bench in M/s **HCL Learning Ltd vs Commissioner of CGST**[3] held that recovery of notice pay is out of the salary already paid and moreover since salary is not covered by the provisions of Service tax, no Service tax can be levied on notice pay recovery. Further, Hon'ble CESTAT – Mumbai Bench in **State Street Syntel Services Pvt Ltd vs Commissioner of CGST**[4], by placing reliance on the ruling of **GE T AND D India Ltd** held that, no Service tax can be levied on notice pay.

Rulings under the GST regime

Contrary to the decisions under the erstwhile Service tax regime, the Gujarat AAR **In re: Amneal Pharmaceuticals Pvt Ltd**[5] has held that GST is payable on notice pay recovery since the same qualifies as supply of service under entry no 5(e) of Schedule II of the CGST Act. Prior to analysing the scope of entry 5(e), the ruling in principle does not delve into and analyse whether notice pay recovery would, as a preliminary requirement, qualify as a "supply" for the levy of GST. On an appeal by the applicant, the AAAR in the said case had a dissenting opinion. Accordingly in terms of Section 101(3) of the CGST Act, it was deemed that no advance ruling could be issued in respect of the question, and thus, the ruling in AAR prevailed.

However, the Madhya Pradesh AAAR **In re: M/s Bharat Oman Refineries Limited** [6], by placing reliance on the decision of Hon'ble Madras High Court in ***GE T AND D India Ltd (supra)*** has held that the amount received as notice pay recovery is not a consideration for any supply of services in terms of Section 7 of the CGST Act. Following the ruling in M/s Bharat Oman Refineries Limited, Maharashtra AAR ***In re: Emcure Pharmaceuticals Limited***[7] and ***Syngenta India Limited***[8] have also held that no GST is leviable on notice pay recovery. The Haryana AAR In re: M/s Rites Limited[9], by placing reliance on the Circular, has also held that no GST is leviable on notice pay recovery.

Comprehending the legal complexity, coupled with the divergent views of the AAR and AAAR and in order to avoid any dispute with the revenue authorities, several taxpayers had discharged Service tax and GST on Notice Pay Recovery. In fact, under the GST regime, various entities have discharged GST 'under protest' on Notice Pay Recovery.

GST Circular dated 03rd August, 2022 clarifying levy of GST on Notice Pay Recovery:

Keeping in mind the differing interpretations of the various judicial forums on the taxability of Notice Pay Recovery, the CBIC, to put a rest to the brewing controversy, has issued a Circular dated 03rd August, 2022, which clarifies the applicability of GST on liquidated damages, compensation and penalty arising out of breach of contract or other provisions of law.

The Circular clarifies that the service of agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act "***is nothing but a contractual agreement***". Accordingly, for a taxable supply to exist there has to be an agreement, whether express or implied, against payment of consideration. Flow of money from one party to another does not necessarily prove existence of an agreement between parties to do an act or abstain from doing an act or to tolerate an act or a situation. Thus, the Circular states that there must be a necessary and sufficient nexus between the supply (i.e. an agreement to do or to abstain from doing something) and the consideration for a transaction to qualify as "supply" under GST.

The applicability of GST on Notice Pay recovery is clarified as follows:

"*7.5.....The provisions for forfeiture of salary or recovery of bond amount in the event of the employee leaving the employment before the minimum agreed period are incorporated in the employment contract to discourage non-serious candidates from taking up employment. Further, the employee does not get anything in return from the employer against payment of such amounts.* ***Therefore, such amounts recovered by the employer are not taxable as consideration for the service of agreeing to tolerate an act or a situation***."

In view of the above clarification, there remains no further ambiguity on the applicability of GST on Notice Pay Recovery by employers. However, on a perusal of the Circular, there is lack of clarity on the applicability of the same with respect to the time period i.e whether the Circular is 'retrospective' (applicable to past transactions from 1st July, 2017) or 'prospective' (applicable to transactions only w.e.f. 04th August, 2022).

In this regard, reference is made to the decision of the **Hon'ble Supreme Court in Commissioner of Central Excise, Bangalore Mysore Electricals Industries Ltd** [10], wherein it has been held that a beneficial circular has to be applied retrospectively while oppressive circular has to be applied prospectively. The said ruling of the Apex court has also been relied in **Suchitra Components Ltd. vs Commissioner of Central Excise, Guntur** [11].

In view of the above rulings, while a view may be taken that the Circular may retrospectively apply to the past transactions of the taxpayers in relation to GST paid on Notice Pay Recovery, practically, it will have to be seen as to how the revenue authorities deal with the refund applications filed by the taxpayers in this regard.

Refund of GST paid on Notice Pay Recovery - Decision of the Hon'ble Kerala High Court in Manappuram Finance Ltd [12]

As a result of the Circular being introduced, the question with respect to refund of GST paid on Notice Pay remained unclear, until the recent ruling of the Hon'ble Kerala High Court in Manappuram Finance Ltd vs Assistant Commissioner, Central Tax and Excise. In the said case, single bench of the Hon'ble Kerala High Court consisting of Hon'ble Mr Justice P. Gopinath held that the petitioner (Manappuram Finance Ltd) is eligible for refund of GST paid on Notice Pay Recovery, as the Circular dated 03rd August, 2022 is retrospective and binding on the Department.

The Hon'ble Kerala High Court in the said ruling held that:

a) It agrees with the assessee's stance that assessee's case is covered by the CBIC Circular dated 03.08.2022 (at para 7.5) which clarifies non-applicability of GST on notice pay received from employees.

b) Circular only clarifies the existing law and thus applies retrospectively.

c) Circulars are binding on the Department and no officer can take a view contrary to stipulations contained in such Circulars.

d) Contention raised by the Department that the petitioner has an effective alternative remedy before the GST Appellate Tribunal is not valid for the simple reason that the GST Appellate Tribunal is yet to be constituted.

e) Refund applications of the assessee stand restored and to be considered afresh by the adjudicating authority in line with the ruling of this case.

What next for Organisations?

In light of the above ruling, which interprets the Circular dated 03.08.2022 to be retrospective and binding on the Department, organisations which have discharged GST on Notice Pay Recovery from their former employees, may contemplate to claim refund of such GST. Further, while claiming such a refund, organisations shall establish that the burden or incidence of GST has not been passed on to their former employees, so as to ensure that there is no unjust enrichment in the hands of the organisations.

An application for refund of GST may be filed by organisations in terms of Section 54 of the CGST Act, which is comparable to Section 11B of the Central Excise Act, 1944. Section 54 stipulates that, any person claiming refund of any tax paid, may make an application before the expiry of two years from the relevant date. However, 'relevant date' as defined under the explanation to Section 54 of the CGST Act does not specifically provide a date (as was the case under Section 11B of the Central Excise Act, 1944) from when refund of GST can be claimed basis a clarificatory circular. The residuary entry under the term "relevant date" means "(h) in any other case, the date of payment of tax". Therefore, strictly speaking, in terms of the residuary entry for determining the relevant date, refund of GST paid on Notice Pay Recovery may be claimed, at least, for two years from the date of payment of tax.

Further, in terms of the ruling of the Hon'ble Kerala High Court in Manappuram Finance Ltd (as discussed above), which has held that the Circular dated 03.08.2022 is retrospective, and no GST is payable on Notice Pay Recovery, a ground that may be adopted while filing the refund application could be that ***Tax collected without authority of law should be refunded to the assesses*** ". In this regard, reference is made to the decision of the Hon'ble Supreme Court in ***Corporation Bank v. Sarawati Abharawsala***[13], wherein the apex court has interpreted the constitutional provision of Article 265 and held that all acts relating to the imposition of tax, inter alia, for the point at which the tax is to be collected, the rate of tax, as also its recovery must be carried out strictly in accordance with law. The apex court therefore held that where the assessee had paid excess amount of tax to the State, which the State had refused to refund, the writ was maintainable, and the assessee was allowed to recover the excess amount paid. This view was also endorsed by the Hon'ble Telangana High Court in**Vasudha Bommireddy, Hyd Another vs Assistant Commissioner Of Service Tax, Hyd** [14] dated 20.12.2019.

It is possible that the Department may contest such a refund application and pass an unfavourable order, in which case, such an order may be challenged by way of a writ petition before the jurisdictional High Court. In such a case, reliance may be placed on the ruling of the Hon'ble Kerala High Court in Manappuram Finance Ltd. However, the said ruling may have persuasive value on other jurisdictional High Courts and revenue authorities. The taxpayer in a particular jurisdiction would ultimately be bound by the final verdict of the respective Hon'ble High Court. In view of this, it is well settled by the Hon'ble Bombay High Court in **Commissioner Of Income-Tax vs Thana Electricity Supply Ltd** .[15], which, inter alia, held that the decision of a High Court is neither binding precedent for another High Court nor for courts or Tribunals outside its own territorial jurisdiction.

Thus, it remains to be seen how this issue evolves across various jurisdictions in the country.

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[1] M.R. Appadurai vs Additional Commissioner for Workman's Compensation and Ors [MANU/TN/0228/1963] dated 09.10.1963 [TS-648-HC(KER)-2022-GST]

[2] [TS-1254-HC-2019(MAD)-ST] dated 7th November, 2019

[3] [TS-1125-CESTAT-2019-ST] dated 25th November, 2019

[4] CESTAT Mumbai dated 25th November, 2020

[5] [TS-108-AAAR(GUJ)-2022-GST] dated 09th February, 2022

[6] MANU/AI/0045/2021 dated 08th November, 2021

[7] [TS-01-AAR(MAH)-2022-GST] dated 04th January, 2022

[8] [TS-12-AAR(MAH)-2022-GST] dated 19th January, 2022

[9] Haryana dated 18th October, 2022

[10] 2006 (204) ELT 517(SC)

[11] 2006 12 SCC 452

[12] [TS-648-HC(KER)-2022-GST] dated 12th December, 2022

[13] 2009 (1) SCC 540

[14] 2020 (35) G.S.T.L. 52

[15] 1994 206 ITR 727 Bom