Pay in lieu of serving notice period - ST/GST implication

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By Abhijit Saha

AS per the charging section 9 of the **Central Goods and Service Tax Act, 2017** (CGST Act) GST is payable on supply of goods and services. "Supply" is defined in section 7 of the CGST Act which is reproduced below for ease of reference:

> ***7(1) - For the purpose of this Act, the expression "supply" includes -***
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> > ***(a) All forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business***
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> > ***(b) â€¦â€¦â€¦..***
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> > ***(c) â€¦â€¦â€¦.***
>
> ***(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.***

In view of the above, it may be stated that the supply has to be in course of trade or commerce. This means that the supply has to be as per the commercial contracts wherein the provider of the service and the recipient of the service and the scope of the service to be provided are clearly mentioned along with the consideration for such service. Hence it is evident that the scope of the service is a certainty and not a contingency and the role of the service provider and the recipient of service is clearly spelt out.

In this backdrop, let us explore whether the notice to pay which is received by the employer from the employee when the employee resigns from the service and pays the said amount in lieu of serving the notice period tantamount to employer providing the deemed service ***"agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act"*** mentioned in serial number 5(e) of Schedule-II of the CGST Act. And if so, will the employer then be liable to pay GST on such amount received from the employee.

Notice to pay recovery happens when there is a breach of the employment contract. Employment contract is an express contract for provision of service by the employee to the employer. The consideration for such service by the employee is the salary and perquisites paid by the employer. It is never to be interpreted to mean a contract for provision of service by the employer to the employee. The entire contract is designed to give a legal sanction to the provision of service by the employee to the employer and all other incidental and ancillary conditions are anchored around the said essential characteristics of the contract for provision of service by the employee to the employer. Hence the notice to pay recovery is like any other conditions like number of casual leave / medical leave / annual leave etc. which are conditions attached to the essential element of provision of service by the employee. Breach of the conditions of such service contract does not automatically results into a diametrically opposite situation whereby the contract becomes a contract for provision of service by the

employer to employee by default. That was not the essence of the employment contract and legally also it cannot be claimed that the breach of the employment contract results into an opposite situation whereby the nature of the contract gets reversed totally and the employer becomes the service provider instead of the employee being the service provider. Such interpretation is devoid of logic and defies all the canons of the interpretation of tax law.

The provision of service as per agreement is a certainty and the consideration for such provision of service is expressly spelt out as such. It is never a case that the agreement to provide service may happen or may not happen depending upon certain contingency. Service agreement cannot depend upon a contingent event. Such contingent event or activity is not designed and expressly intended as provision of service in the service agreement. The parties to the contract should know what is the nature of service to be provided under the agreement and who is the service provider and who is the recipient of service. Such understanding is the cornerstone of a valid agreement. Agreement to provide the service cannot be left to an uncertain situation which has no guarantee to happen.
The service agreement does not depend upon a probable event. It is a definite promise by employee to provide service to the employer and not the other way round.

In view of the above, it may be stated that any breach of the service agreement (where the employee would provide service to the employer) can only be treated as breach of the condition for such employment contract and does not automatically results into role reversal. There is no warrant neither in the law nor in the service agreement to make such interpretation.

In case of declared service also (Schedule-II), it is an express agreement to provide the service by refraining from an act, or to tolerate an act or a situation, or to do an act. Hence non-compete fee for example is an abstinence from an act which is expressly provided in the contract with an express consideration for such abstinence activity. It can never be a default provision. It is a deliberately designed abstinence activity as agreed upon and hence qualify as provision of service. Such service is provided not by way of breach of the contract. Service is always provided by complying with the terms of the contract
. When there is a breach of contract that means the conditions are breached. It does not automatically results into provision of diametrically opposite service by way of role reversal.

The exact nature of the service and who is the service provider and who is the recipient of service, is clearly mentioned in the agreement. There is no scope to create an exception and shift the position without the express stipulation in the contract and allege that the recipient of service is the service provider and the provider of service is the recipient of service in any given eventuality. Hence, the breach of the condition of the employment contract by the employee does not diametrically change the character of the service agreement and make the employer the service provider.

The provision of service (supply) as explained above should be in course or furtherance of business. Hence such provision of service should be as per the contractual agreement between the employer and the employee. Hence for aforesaid clause of declared service to be invoked there has to be, first, a concurrence in the contract itself for the employer to assume an obligation to refrain from an act or to tolerate an act or a situation; in the capacity of being a service provider. In absence of such obligation explicitly mentioned in the employment contract, said clause cannot be invoked. Such obligation flows from the terms and conditions of the contract. In the present case, the subject agreement **does not stipulate**
that the employer has any obligation to tolerate an act and such tolerance is construed to be a service provided by the employer for which expressly there is a mention of consideration as **quid pro quo.**

In the case of ***Cricket Club of India v. Commissioner of Service Tax - 2015-TIOL-2062-CESTAT-MUM*** it was held:

> ***10. Chapter V of Finance Act, 1994 is intended to tax services. The relevant charging section, therefore, cannot and should not be read beyond the transaction that is intended to be taxed. Plainly expressed, only services can be taxed. â€¦â€¦â€¦â€¦â€¦â€¦â€¦â€¦.***
> ***the tendency to seize upon the tangibility of the flow of compensation to presume the existence of a service becomes irresistible. And that is when the tax determination exceeds legislative intent.***

11. â€¦â€¦â€¦â€¦â€¦â€¦â€¦â€¦â€¦â€¦. Consideration is, undoubtedly, an essential ingredient of all economic transactions a certainly consideration that forms the basis for computation of service tax.
However, existence of consideration cannot be presumed in every money flow. Without an identified recipient who compensates the identified provider with appropriate consideration, a service cannot be held to have been provided.
â€¦â€¦â€¦â€¦â€¦â€¦â€¦â€¦â€¦â€¦.â€¦â€¦â€¦â€¦. a service that is clearly identifiable has to be provided or agreed to be provided taxed. The factual matrix of the existence of a monetary flow combined with convergence of two entities for such flow cannot be moulded by tax authorities into a taxable event without identifying the specific activity that links the provider to the recipient.

In view of the above, as per the understanding of the author, the amount which the employee pays to the employer in lieu of **not** serving the notice period **does not** qualify as consideration for any service provided by the employer.

(The views expressed are strictly personal)